CHAPTER VI

UNITARY BIAS VIS-A-VIS FINANCIAL RELATION

A. INTRODUCTION

Finance is the most important factor in any constitutional scheme of distributing powers between the Union and States in a federal set up. Working of the federal system is, in a very large measure, influenced by the manner in which financial power or power to raise revenue is allocated to the Union and States. Any arrangement in the financial sphere worked out by a federal constitution cannot and will not remain sacrosanct for all time to come. It is bound to prove its inadequacy or ineffectiveness as a sequel to the onslaughts of rapidly changing times. Yet it does not mean that the task of devising a fairly workable and acceptable financial arrangement in a federal set up would be an insurmountable

one and defy solution. As the Government itself is a never ending adventure in the vast political laboratory, no arrangement, let alone financial arrangements, can claim the sanctity of importunity or label of universality. Federal experiment in such countries as the United States, Switzerland, Canada, Australia, Germany and other countries in Latin America have provided conclusive evidence that a less doctrinaire and more pragmatic and reasonably elastic financial arrangement based on the principle of independence, adequacy and stability is the irreducible minimum for the satisfactory functioning of the federal system. Because a system of revenue allocations may seek to achieve a number of objectives. It may aim at good government, try to safeguard the autonomy of the unit-governments, promote political stability, facilitate rapid growth, bring about financial equalisation or foster financial responsibility. These objectives require enumeration of policy objectives through a system. But the policy objectives are bound to be constantly under change, and such changes would affect any ideal system of distribution of revenue, which must also change if the intended objectives are to be pursued. This is why it has become necessary in most federations to use devices such as the delegation of power to expert commissions, distribution pool arrangements, or fixed

formula grants, which help to establish desired framework of financial relations, limit conflicts between governments and achieve the required degree of flexibility. It has been aptly said, there is and can be no final solution to the allocation of financial resources in a federal system. There can only be adjustments and reallocation in the light of changing conditions. These changing conditions make it impossible to lay down a basic structural balance for any federal constitution which can remain static. Even if, initially, one could formulate an equitable balance between the functions and resources of the general government and the units, changing economic conditions and growing demands of public welfare would soon upset the initial balance. This limitation is to be born in mind while assessing the socio-legal implications of Centre-State Financial Relations.

Any study of the scheme of distribution of powers in the Indian Federal System will not be complete unless an attempt is made to examine in depth the manner in which the sources of revenue are distributed between the Union and States. This necessitates a careful and unscrupulous study of financial aspects of the Union State Relations as covered by Arts. 268-281, 285-289, and 292-293 and the scheme of

distribution of powers, more particularly the fiscal and taxing powers adumbrated in the Union and State lists in the VII schedule. Since the financial relations is to constitute only a part of our investigation, inspite of the fact that this aspect itself can produce few theses, attempt will be made to encompass only those aspects which have got only the socio-legal bearing. Before examining these provisions in the socio-legal context it is necessary to review the object of the financial relations as revealed in the debate of the constituent Assembly and elsewhere.

B. FINANCIAL RELATIONS AND THE CONSTITUENT ASSEMBLY

The constituent Assembly set up in January 1947, the Union Powers Committee with 12 members, which submitted its first report in April 1947 recommending that the Centre be given the powers over Defence, Communications and Foreign Affairs and indicating certain sources of revenue. In the second report of the Drafting Committee, the concurrent list was drawn up containing an entry entitled "Economic and Social Planning". This has remained there upto the moment. The recommendation was that there should be an Expert Committee, which came to be known as the Finance Commission in the Constitution of 1950.
In the constituent Assembly, some provincial members put pressures for increased provincial revenues but "when provincial representatives called for increased provincial revenues they did so out of pride and desire that their province might meet social responsibilities rather than any dream of provincial autonomy". For example, in the constituent Assembly Alladi Krishnaswami Ayyar while accepting the central Government's taxing power insisted that the Union should, at the same time, take care that the Units shared in the proceeds of taxes and received other subsidies. Mohd. Sedullah, a Muslim League member from Assam while pleading for liberal grant for Assam, deplored the absence of any constitutional provision for financial help to the poorer and needy states.

"In the twenty memoranda from Provincial Governments to the Assembly about sale tax and on distribution of revenues, each placing the strongest possible claim for increased funds, no provincial Government couched its demands in terms of its protecting its autonomy or of states rights," inspite of knowing the fact that the provinces were going to have inelastic revenue resources.

The Constituent Assembly appointed few Committees to report on different financial problems. The State Finance Committee appointed in 1948 concerned itself with the problems of federal finance integration but not the sharing of revenues between the Centre and the States. The Expert Committee constituted under the chairmanship of Mr. M.R. Sarkar by the Constituent Assembly was to consider:

(1) allocation of taxes between the Centre and the States as regards legislation, levy and collection;

(2) the net proceeds of which taxes are to be retained entirely by the centre, the net proceeds of which taxes are to be made over to the units, and the net proceeds of which taxes are to be shared between the Centre and States;

(3) on what principles the taxes are to be shared between the States and the Centres and

(4) what is to be the machinery for determining the shares. The Sarkar Committee thought that not less than 60 percent of the net proceeds of Income-tax (including corporation tax and the tax on federal emoluments and
succession/ estate duties) should be divided between provinces.

The proceeds of excise and tobacco were to be divided between the provinces on the basis of the estimated consumption not being less than 50 percent. The Committee suggested the appointment of a Finance Commission -

1. to allocate between provinces the respective shares of the proceeds of taxes that have to be divided between them;

2. to consider applications for grants-in-aid for provinces and report thereon;

3. to consider and report on any other matter referred to it by the president.

Regarding Central Excise the Committee recommended that the Provincial Governments should be given a share in one of the Central Excises on a commodity not receiving tariff protection and that 50 percent of the same (in this case tobacco) should be distributed to the provinces on the basis of estimated consumption. It was not in favour of segregating agricultural income-tax from general income-tax. The Committee recommended the appointment of a Finance Commission with a chairman and thereafter one in five years to allocate between the provinces the respective shares of the proceeds of taxes that have to be divided between them. Applications for grants-in-aid from the provinces, etc.
The Sir V.T. Krishnamachari's Committee was set up in October 1943 for the purpose of considering the impact of financial integration with Indian states which had until then remained outside fiscal system of the rest of the country, except for specific agreements entered into with the Government of India regarding such matters as customs, central excise, post and telegraphs and railways. In a Transitional Period, the centre agreed to provide to certain states the difference between the revenue loss to them from Union subjects and services. These, what were called the "Revenue gap grants" were granted for the first five years and on a gradually diminishing scale for a further five years.

The recommendations of the Expert Committee were doubtless useful. The report though not fully accepted, is an important landmark in the history of federal finance in India. The question of grants-in-aid was disposed of with a suggestion that it should be left to the Finance Commission.

Summing up the history of federal finance during the pre-independence period, Sudha Bhatnagar observes, "it was only to this end that some kind of autonomy was granted to the provinces under the Act. of 1935, so that British Rule could be extended to as long
as possible, if not perpetuated. The modest beginning made in the direction of granting political and financial autonomy to the provinces were initiated by political development in the country and abroad and the federal finances structure envisaged under the Government of India Act. 1935 never really emerged. As regards the period immediately after independence a near status quo was maintained in the federal finances set up".  

C. CONSTITUTIONAL SCHEME

Like in other federations, in Indian Federation also has supervened a disequilibrium between financial resources. The constitutional provisions of India are so framed that the Union Government has emerged with a surplus of resources, while the State Governments have been left with more functions than they can pay for it. But attempts have been made to redress this imbalances through various transfer of some state functions to the Union e.g. use of central para-military forces in the states on state's request. But inspite of this effort, "in a system of Government where the centre and the states have been given separate responsibilities and functions, there is a basic..."

difficulty of allocating taxing powers commensurate with those responsibilities and functions. Any imbalance in this matter is bound to create centre-state tensions. In assigning taxing powers to the Union and the constituent states a number of factors are relevant and have to be balanced. They are -

(1) taxes with local base generally have to be given to the states, but because of economic disparities amongst the states some exceptions may have to be made even in this regard;

(2) where the basis of tax and its impact is nation-wide, it will not be advisable to empower the states to levy the tax;

(3) where there are possibilities of multiple burdens, it will be a strong factor in favour of centralisation of the tax. The dangers of multiple burdens are real in a federation where centre and regional units operate on the same people, commodities and transactions. Apart from multiple burdens being imposed by the different units, it creates the difficult problem of administrative compliance by the individual;

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(4) Diversity in the state laws imposing the same kind of tax within their local limits, e.g. states tax, may create its own economic problems;

(5) in a country with great regional disparities, the centre must have a substantial surplus of revenue over its own needs so that it can perform the role of equaliser;

(6) in spite of the presence of different factors warranting non-assignment of certain taxing powers to the states, still some concession may have to be made in favour of the states on account of their needs.

The constitution makers being conscious of these problems provided for an elaborate scheme of centralisation of certain taxes and then assignment of the proceeds therefore through tax-sharing and other means.

The financial aspects of the Union State Relations is covered by Arts. 268-281, 285-289 and 292-293 and the scheme of distribution of powers, more particularly the fiscal and taxing powers adumbrated in the Union and State lists in the VII schedule. As the provisions of Arts.

268-281 refer to the distribution of revenue between the Union and States, entries 82-92 and 92A in list I and entries 45-63 in list II refer to the taxing powers, i.e. power to levy taxes and duties of various kinds, are given to the centre and states respectively. Though both the Union and States are empowered to legislate and act in respect of matters in the concurrent list, hardly there is any taxing power worth in the concurrent list. Thus both the Union and the States each of them are given separate taxing powers to enable them to raise their revenues independently of the other. Under this arrangement neither the Union is at State's mercy nor the states are at the mercy of the union in raising their revenues. Apart from these separate sources of revenues given to the centre and states, also there are explicit constitutional provisions (Arts. 268-281) for distribution of revenues between the Union and States, a task in which the quinquennial Finance Commission\textsuperscript{11} is assigned with a very important role to play (vide Arts. 280-281). Although these details concerning the financial arrangements between the centre and states is no less significant what is most crucial from the view point of examining the degree of federalism is whether this financial arrangement has been organised on the basis of the principles of independence, adequacy and stability or not.\textsuperscript{12}

\textsuperscript{11} Art. 280.

The idea behind these constitutional provisions is to avoid overlapping and multiple burdens, to achieve uniformity, and to ensure efficient working of the economic system on the one hand, and to meet the financial needs of the states on the other. In the constitution, as adopted, there were broadly five areas of revenue:

1. Exclusively state sources;
2. Taxes levied and collected by the centre but assigned to the states;
3. Duties levied by the centre but collected and appropriated by the states;
4. Taxes levied and collected by the centre and shared by the centre and states and
5. Exclusively central sources of revenue.

The main provisions under the constitution which largely govern the fiscal relationship between the Union and the States are as follows:

1. Art. 268 refers to duties levied by the Union but collected and wholly retained by the States. Here, the centre discharges only agency services.

13. Stamp duties in respect of Bills of Exchange, cheques, Promisory notes, Letters of credit, policies of insurance, transfer of shares and excise on medicine and toilet preparations containing alcohol.
(2) Art. 269 refers to taxes levied and collected by the Union but whose proceeds are given over to the States.  

(3) Art. 270 refers to the taxes levied and collected by the Union, but whose proceeds are shared between the union and the states.

(4) Art. 272 refers to taxes which are levied and collected by the Union Government but whose proceeds may be distributed among the states in accordance with such principles as may be formulated by a Union law.

(5) Art. 275 makes provision for certain grants-in-aid to states from the Union fund.

The transfers of finance from the Union to the States are intended in the constitution to be governed by various articles of the Constitution, which are made largely on the recommendations of the Finance Commission. In addition to this provisions, the constitution also

14. Duties in respect of succession to property other than agricultural land, estate duty on property, terminal taxes, and passengers, taxes on railway fares and freights, taxes on the sale on purchase of newspapers and advertisements.

15. Income tax is the only item which comes under this head except the surcharge on income tax.

16. Under this head comes union duties of excise other than those on medicinal and toilet preparations.

17. Arts. 269, 270 and 275 of the Constitution of India.
provides for grants for any public purposes which can be made by the Union Government. Thus having made provisions for federal assistance to the states, both as grant-in-aid and as a share of specified taxes, the constitution visualised the necessity for a machinery independent of Union Government to determine the measure of assistance that should be provided and also the principles on which this assistance should be made available. This machinery known as Finance Commission is to be appointed by the president in every five years so that such periodical adjustments can be made in the Union State financial relationship as needed in the light of emerging situation.

The Finance Commission is a unique experiment in the Indian Federalism. It has been envisaged by the framers of the constitution and incorporated in Art. 280 as a quasi-arbitral body whose function is to do justice between the centre and the state.

Apart from the Finance Commission, the constitution visualises another two bodies for transferring funds to the states. They are -

(1) Planing Commission to meet plan expenditure (both revenue and capital) and
(2) discretionary transfers by exercising the executive authority of the Union Government to meet unforeseen exigencies of the states outside both the Finance Commission and Planning Commission.

The Finance Commission is a unique experiment of its kind in India whose function is to make recommendations to the President of India as to:

(a) the distribution between the Union and the States of the net proceeds of taxes which are to be, or may be, divided between them under this chapter and the allocation between the states of respective shares of such proceeds.

(b) the principles which should govern the grants-in-aid of the revenues of the states out of the consolidated fund of India.

(c) any other matter referred to the Commission by the President in the interest of sound finance.

The financial scheme as laid down in the constitution is an ideal scheme from the points of view of the economic system, administrative compliance, the difficulties faced by other federations which our
constitution makers so sagaciously avoided. Without such a scheme our economic difficulties would have been anormous as is shown by sale-tax and taxes on motor vehicles assigned to the States. For instances, to tackle the economic problems arising out of state sales-tax several things had to be done; enactment of central sales tax Act. 1956; levying additional excise duties in lieu of sale-tax on a few commodities; and creation of four Sales Tax Zonal Councils is not entirely satisfactory from the economic point of view.\(^{18}\)

Similarly, a tax on motor vehicles imposed by the States within their local limits gave rise to the problem of multiple burdens on a vehicle passing from one state to another. The matter was examined in 1967 by the Road Taxation Enquiry Committee on Inter-State Transport. It had recommended that the taxes on vehicles and carriage of goods and passengers should be consolidated into one tax and that a graded inter-state standard tax based on the distance covered by the vehicle outside its home state be imposed by the state where the vehicle is registered.\(^{19}\)

D. FINANCE COMMISSION

The Finance Commission is an authority without parallel in other federations.\(^{20}\) A somewhat similar institution which bears some resemblance to it is the commonwealth grants

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19. Ibid. p. 3.
Commission of Australia. However, there are significant
differences between the two institutions in regard to their
status and field of operation. The Indian Finance Commission
is a constitutionally created body and unlike the Commonwealth
grant commission of Australia, it is not a standing body.
Transfer of finance from the Union to the states are made
largely on the recommendations of the Finance Commission.21
The Commonwealth Grants Commission, constituted in 1933 by
the Commonwealth Parliament, is a permanent body which
recommends fiscal grants to the deficit states of Western
Australia and Tasmania. While in Australia, members are
appointed for three years, in India, they are appointed for
nearly a year and after the commissioner's assigned task is
completed it becomes functus officio. Thus there is no
continuity in the Commission's task. Further Indian Finance
Commission has larger functions to discharge than its Australian
counterpart in that the former has to recommend tax sharing
between the Union and the states as well as fiscal need grants
to states. In addition, other questions of inter-governmental
financial relationship are also referred to it from time to
time. The provision of Finance Commission is intended to
ensure that the scheme of distribution will be made not by the
Union arbitrarily, but will be based on the recommendation of
an independent commission, which assesses the changing needs
of the states in making the recommendations.

Since the commencement of the constitution in 1950 eight Finance Commissions have been constituted. All the Commissions have followed the practice of visiting the states, consulting ministers, senior officials of the Union and the State Governments, member of officials of the union and the state governments, members of the officials of the planning commissions and receiving memoranda and oral evidence from the individuals and representatives of interested organisations before formulating their recommendations for submission to the President of India.

E. TRANSFER OF FINANCES TO STATES

Whatever inadequacy and lacuna from which the existing constitutional provisions have been suffering from they have been overcome very considerably by the Finance Commission and the Planning Commission. In view of the growing financial requirements and needs of the states accelerated by the ever expanding nation building activities the successive Finance Commissions have shown greater understanding, sympathy and magnanimity in taking note of state's acute financial problems and consequently recommended larger and larger share to the states in the distribution of tax revenues. Tables 1 and 2 given on the next pages, which show the magnitude of financial transfers from the Union to the States through the Finance Commission, Planning Commission and other transfer.


## TABLE NO. 1.

Transfers of Finance to the States by Broad Category:
F.COM., P.Com., Other transfers,
1951-52 to 1984-85.
Rs. in crores.

<table>
<thead>
<tr>
<th>Period</th>
<th>Fin. Com.</th>
<th>Plan. Com.</th>
<th>Other transfers</th>
<th>Total transfers</th>
</tr>
</thead>
<tbody>
<tr>
<td>1st. plan</td>
<td>447</td>
<td>880</td>
<td>104</td>
<td>1431</td>
</tr>
<tr>
<td>2nd plan</td>
<td>918</td>
<td>1058</td>
<td>892</td>
<td>-2868</td>
</tr>
<tr>
<td>3rd plan</td>
<td>1590</td>
<td>2738</td>
<td>1272</td>
<td>5800</td>
</tr>
<tr>
<td>Three annual plans 1966-67 to 1968-69</td>
<td>1782</td>
<td>1917</td>
<td>1649</td>
<td>5347</td>
</tr>
<tr>
<td>4th plan</td>
<td>5421</td>
<td>4731</td>
<td>4949</td>
<td>15101</td>
</tr>
<tr>
<td>5th plan</td>
<td>11168</td>
<td>10353</td>
<td>3761</td>
<td>25282</td>
</tr>
<tr>
<td>6th plan</td>
<td>20843</td>
<td>13962</td>
<td>A.M.</td>
<td>-</td>
</tr>
</tbody>
</table>

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Note: Fifth plan figures include R.E. for 1977-78 and H.E. for 1978-79.
TABLE NO. 2.

Total Transfers of Resources from the Union to the States
1951-52 to 1978-79
Rs. in crores.

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1st plan</td>
<td>344</td>
<td>288</td>
<td>799</td>
<td>1431</td>
</tr>
<tr>
<td>2nd plan</td>
<td>668</td>
<td>789</td>
<td>1411</td>
<td>2868</td>
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<tr>
<td>3rd plan</td>
<td>1196</td>
<td>1804</td>
<td>2676</td>
<td>5347</td>
</tr>
<tr>
<td>Three annual plans.</td>
<td>1282</td>
<td>1383</td>
<td>2676</td>
<td>5347</td>
</tr>
<tr>
<td>4th plan</td>
<td>4562</td>
<td>3831</td>
<td>6708</td>
<td>15101</td>
</tr>
<tr>
<td>5th plan</td>
<td>8337</td>
<td>8135</td>
<td>8810</td>
<td>25282</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Note:- Includes following loans not taken into account in the B.F. for 1978-79.

I. Loans to cover gap in resources ... 427
II. Loans as advance plan assistance ... 143

Total: 572
A careful scrutiny of the above tables reveals as follows:

(1) The magnitude of financial transfers to the states has increased very much over the plan periods signifying the growing financial dependence of the states on the Union.

(ii) The transfer of funds to the states through the Planning Commission and other discretionary transfers by the executive authority of the Union taken together has become almost twice the amount of transfers made on the basis of Finance Commission’s recommendation. This shows that the statutory transfers of funds has become less important than the increasing of the central influences and control over the states as regards their disbursements and consequently it has become a source of criticism that a super Constitutional body i.e. Planning Commission is devouring the function of the constitutionally created body i.e. Finance Commission.

(iii) In the matter of transfers of funds it is not shared taxes and grants (whether made by Finance Commission or Planning Commission) which are important but the loans which have emerged as one of the major components of funds to the states. The ratio of loans and grants being not uniform in regard to all states, it effects their revenue budget, more when their mode of repayment and interest charges vary. This is another instance as to how, as the critics put it, the union has put the states under the financial pressures.
Mr. Rajendra Jain requires a re-orientation of both the Finance and Planning Commissions, the former should help the states as air cover to the front line fighting forces while the latter should act to strengthen the base and supply line in maintaining and consolidating the occupied area operations. Between 1951-52 and 1982-83 about more than 90,000 crores of rupees were transferred, the resource transfers also do not take note of the widening gap between resources and functions of the less developed states. The present state of affairs defeats the federal objectives of removing disparities between the states and the gap between effluent states and poor states has actually been widened in the years. Both the Commissions, he says, are functioning as agencies of the central government and there has been no proper allocation of National Resources. He appends the following table, with column 5 worked out by the Planning Commission.

<table>
<thead>
<tr>
<th></th>
<th>1951-52</th>
<th>1982-83</th>
<th>Increase (in times)</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Revenue Received</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(a) Union</td>
<td>579</td>
<td>22,756</td>
<td>30</td>
<td>39</td>
</tr>
<tr>
<td>(b) States</td>
<td>396</td>
<td>20,210</td>
<td>50</td>
<td>51</td>
</tr>
<tr>
<td>2. Tax Revenue</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(a) Union</td>
<td>460</td>
<td>17,910</td>
<td>36</td>
<td>39</td>
</tr>
<tr>
<td>(b) States</td>
<td>227</td>
<td>9,151</td>
<td>39</td>
<td>40</td>
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<tr>
<td>3. Capital Receipts</td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>(a) Union</td>
<td>213</td>
<td>12,446</td>
<td>57</td>
<td>58</td>
</tr>
<tr>
<td>(b) States</td>
<td>135</td>
<td>5,891</td>
<td>47</td>
<td>44</td>
</tr>
<tr>
<td>4. Total Aggregate Receipts</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(a) Union</td>
<td>782</td>
<td>35,202</td>
<td>43</td>
<td>45</td>
</tr>
<tr>
<td>(b) States</td>
<td>531</td>
<td>26,101</td>
<td>48</td>
<td>49</td>
</tr>
<tr>
<td>5. Revenue Expenditure</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(a) Union</td>
<td>391</td>
<td>10,415</td>
<td>50</td>
<td>51</td>
</tr>
<tr>
<td>(b) States</td>
<td>393</td>
<td>18,849</td>
<td>37</td>
<td>48</td>
</tr>
<tr>
<td>6. Capital Expenditure</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(a) Union</td>
<td>293</td>
<td>14,826</td>
<td>80</td>
<td>51</td>
</tr>
<tr>
<td>(b) States</td>
<td>189</td>
<td>7,640</td>
<td>39</td>
<td>40</td>
</tr>
<tr>
<td>7. Total Aggregate Disbursement</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(a) Union</td>
<td>674</td>
<td>34,241</td>
<td>50</td>
<td>51</td>
</tr>
<tr>
<td>(b) States</td>
<td>582</td>
<td>26,489</td>
<td>49</td>
<td>46</td>
</tr>
</tbody>
</table>

In spite of such criticism, it must be admitted that ever since the time of the appointment of the first Finance Commission and acceptance of its report by the Union Government, a convention, which has been scrupulously observed, has developed to the effect that the Union Government would act faithfully in terms of the Commission's report with regard to the allocation to the states of the net proceeds of the taxes. This has resulted in the following of larger and larger, as revealed by table 1 and 2 given earlier, amount of money from the centre to the states which has eased considerably the financial problems of the letters and their financial inadequacy. Whatever gaps in this respect, which would not have been effectively bridged by means of constitutional amendments have been met reasonably and adequately by the role of Finance Commission and convention developed in connection with its working. The critics who have been clamouring in and out of season for constitutional amendments to the fiscal provisions of the constitution should not belittle or underestimate the importance of this trend. Similarly, the Planning Commission, and its offshoot, the National Development Council, an extra constitutional development

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26. Supra, p. 207-208

of unprecedented magnitude, have come to play a pivotal role in the sphere of the fiscal aspect of the centre-state relations. Development Planning, no doubt, has accentuated the scale of public expenditure which have imposed crushing burden on the state's financial position which is not very happy. But the recommendations of the Planning Commission based on its assessment of the state's financial position has obliged the centre to give sizable amount of money to the states to meet squarely their financial requirements entailed by the implementation of development plans. This role of the Planning Commission has contributed in no less a manner to enable the states to get reasonably adequate finance. Considering the size of the financial grants and aid the states have been able to obtain from the Union which has been acting on the basis of the Planning Commission's assessment and recommendations, it is not certain if the states had been able to augment sufficiently their finance had the constitution been emended suitably to transfer some more fiscal powers to the states just to appease the demands of the champions of the state's viewpoint, a viewpoint underlying the thesis that the states could get financial problems solved and bettered their finances by


transferring some more taxing and fiscal powers from the Union list to the State list which necessitates constitutional amendment. The Administrative Reform & Committee study team on Centre-State Relations was categorically against any such transfer. It stated:

"The first thing to consider in this connection is whether some of the sources or revenue at present allotted to the centre could be transferred to the states. This, in fact, would be the only method of reducing dependence as such. But the country being a single economic unit any transference of sources that occurs is, for reasons of administrative convenience, more likely to take place in the opposite direction, sales tax affords a good illustration, for here is a state tax which for reasons of economy and efficiency of effort, should perhaps gradually give way to central excise duties. Another method of assisting the states could be exploitation of taxes mentioned in Art. 200, which are leviable only by and at the discretion of the centre with the proceeds going to the states. But this would have only a limited impact and may not provide a solution to the problem of dependence on the centre. With these two possibilities ruled out, it would appear that the phenomenon of financial dependence of the state is, in a sense, unavoidable."

It may be an over-emphasis but it will not be certainly a gross distortion or misrepresentation of the stark facts that what the constitutional amendments could

30. Reports on CSR by the AEC Study Team, pp. 22-24.
not have ensured, the Finance Commissions and the Planning Commission have not failed in enabling the states to get reasonably enough resources from the centre. The effective remedy for the states financial problems lies not in the constitutional amendments but in their grit, resolute will and tenacity to manage their finances in a disciplined, rational and purposeful and exemplary manners and observing in thought, word and deed the canons of faithfulness, economy and wisdom in their public expenditure and adhering strictly to the time schedule in the implementation of development plans. The advent of the planning Commission and its role in the formulation of development plan and the resultant impact on the centre-state relations, more particularly administrative and fiscal, constitute the most outstanding development in the theory and practice of constitutionalism in the post constitution period. The Planning Commission, though an extra-constitutional development derives its constitutional descendency from entry No. 20 entitled the social and economic planning in the concurrent list. Thus the critics need not be unduly concerned about the legitimacy of the Planning Commission or its role in the influencing and conditioning the Union-State Relations. This kind of concern showing pessimism or skepticism is understandable in view of the fact that of the two bodies - The Finance Commission and Planning Commission, the latter has come to play more
decisive role in the sphere of the centre-state relations. This trend has prompted many a critic to suggest a major change in the role of Finance Commission by making it a permanent body and entrusting it with the function of the Planning Commission particularly in determining the quantum of financial aid to be given to the states to enable them to implement the development plans in the formulation of which the Planning Commission plays the most predominant role. Critics and publicists who have favoured this change would seem to have overlooked or side-tracked certain constitutional, political and administrative realities and procedural niceties.

In terms of Art. 280 the Finance Commission is a quinquennial body. But there is no constitutional bar on the president that he should appoint the commission only once in five years. The constitution provides that once in five years or at such early date as the president considers necessary appoint the Finance Commission for the purposes specified in Ch. (3) of Art. 280. But under the Indian Constitutional System the President's consideration means the consideration of the Council of Ministers. This means that in terms of Art. 280 nothing prevents the Ministry to advise the president to appoint the Finance Commission earlier than the five years rule if it considers it necessary.

32. Ibid. p. 182.
But so far in the matter of appointment of the Finance Commission, the centre has followed constantly the practice of five year-rule in advising the President about the appointment of the Commission. As per the practice that has been in vogue ever since 1950, when once the Commission is appointed, completed its work and submitted its report and follow-up action is taken in terms of its recommendation, this will be in force for the next five years until the next commission is appointed. As per the growth of a convention, the Government of India accepting into the Finance Commission's recommendations and initiating follow-up action in terms of the same, pending the appointment of the next commission, has become a firm constitutional practice. Then the Union Government's follow-up action pursuant to the Finance Commission's recommendations will remain unaltered pending the appointment of the next Finance Commission. This has been going on uninterruptedly since 1950. What is important in respect of the Finance Commission's recommendation is necessary follow-up action to implement the same in letter and spirit. What the critics wanted by making Finance Commission permanent body is perhaps some continuity in the Finance Commission's work of assessing the financial position and needs of the states and recommending suitable allocation of tax revenue to them and a sort of corresponding continuity in follow-up action of the Union Government to implement the same. The effect
of this kind of action has not been difficult to be accomplished by the growth of the healthy convention and the resultant attitude of the Union Government in giving effect to the recommendations of the Commission after Commission. It may not be difficult but it will not be very easy for the centre to reverse this trend in future.\textsuperscript{33} This important and sound constitutional development in respect of the followup action on the report of the Finance Commission should not be prevaricated by the critics and commentators\textsuperscript{34} who have been over emphatic in making the quinquennial Finance Commission a permanent body. What the Finance Commission of a permanent character could have hoped to accomplish has not become impossible to be ventured by the Finance Commission a quinquennial body, in collaboration with the followup action of the Union Government.

The advent of the Planning Commission and its ever expanding role in the Planning process and the pervasive influence it has brought through its recommendations to bear upon the centre in determining and allocating the quantum of aid from the centre to the states has invariably resulted in overshadowing, if not emasculating completely


\footnotesize{\textsuperscript{34} Ibid. p. 114.}
the Finance Commission. In allocation of financial grants to the states for enabling them to implement development plans the centre's action has been in pursuance of Art. 282 which allows the centre to make any grant for any public purpose notwithstanding that the purpose is not one with respect to which parliament may make laws. Owing to the magnitude of development planning and the unprecedented expenditure it has entailed, the size and amount of financial aid that the centre has been giving to the states is more impressive and important in contrast to the allocation of revenues to the states in pursuance of the Finance Commission's recommendations and the centre's follow up action. This markedly discernible gap in the size of the allocation of the revenues and financial grants to the states for implementing development plans in terms of recommendations of the Finance Commission and Planning Commission respectively would seem to have provoked the critics and commentators to conclude that at though the Planning Commission, an extra constitutional agency, has behaved like a colossus towards the Finance Commission, a constitutional creature. This has made them to come out with a suggestion that the Finance Commission should be empowered to assess the state's need in respect of the financial needs in respect of development plan's implementation.\textsuperscript{35} Those who have mooted

\textsuperscript{35} Bakshi, S.P. op.cit. p. 114.
this proposal do not seem to have appreciated its implications or given adequate consideration to the difficulties and problems with which the proposal bristles. There is considerable difference between the role of the Finance Commission and that of the Planning Commission in recommending the distribution between the Union and States, the share in the net proceeds of taxes and the size of development grants respectively to the states. If the mere size or magnitude of finance that flows from the Centre to the States were deemed to be the criterion for judging the relative importance and influence of either of these bodies—the Finance Commission and the Planning Commission—it is the latter body that is entitled to be considered as important and influential in helping the states to get a very sizeable amount of money from the Centre. But it would be a too simplistic view of the problem. No doubt, unlike the Finance Commission, a creature of the Constitution, the Planning Commission was brought into being by the executive order of the Union Government. In spite of this, the Planning Commission, over the years, has grown into a very decisive body of considerable prestige, influence and importance. 37 Many


factors, important among them being charismatic leadership and near uniparty dominance, have contributed to this unique development. Whether the proposal which seeks to make the Finance Commission responsible for suggesting the size of development grants from the Centre to the States would be feasible, desirable, practicable and workable, it is essential to recall here the functions of both the Commissions. Under Art. 280(3) the Finance Commission is required to recommend the distribution between the Union and States the net proceeds of taxes under Chapter I of part XII, the principles which govern the grant-in-aid of the revenues of the States out of the consolidated fund of India, and any matter (referred by the President to the Commission), in the interest of sound finance. The Planning Commission, among others, is concerned with assessing the Nation's resources and formulating comprehensive plans, progress achieved in implementing development plans, locating factors regarding plan implementation and assessing the states' resources and recommending to the centre the size of development grants to be given to the states for implementing development plans. A glance at these various functions of the
Planning Commission reveals that all these functions are inter-related and integrated. If all these functions are to be performed in a balanced manner would it be a sound proposal as has been mooted to entrust the Finance Commission with the Planning Commission's important task of assessing the state's resources position and suggesting to the centre of the size of development grants to be given to the states? As all the principal functions of the Planning Commission are closely interlinked and inter-related the effective and useful performance of any of these functions cannot be separated from its other functions.

The Planning Commission has become a very dynamic and positive instrument in accelerating the momentum of development and accentuating the pace of change for the better. This role of the Planning Commission can be ensured provided the Planning Commission is allowed to perform all its related functions, without any undesirable interruption, in a functionally integrated and balanced manner. Instead of doing this if the Planning Commission were divested of this important function and the same were yoked to the Finance Commission, this would lead to the unnecessary removal by amputation from the Planning Commission one of its important functional limbs. This unnecessary, undesirable and ill-thought out amputation, political, administrative and financial would result in neither the amputated planning commission performing
its remaining functions in a very effective and laudable manner nor the bloated the Finance Commission which acquires, one more functional appendage by some kind of not too easy plastic surgery, from the Planning Commission would be able to do more justice to the purpose which the Planning Commission has not attempted to do. Neither the truncated Planning Commission nor the bloated Finance Commission would be desirable. The critics and commentators who mooted this proposal should have pondered over all these possibilities and undesirable consequences. Unmindful of this analysis should be the proposal be acted upon the consequence will be confusion worse confounded. The critics who favoured this proposal ought to have admitted without any inhibitions that the advent of the Planning Commission though it has to play a very crucial role in enabling the states to obtain from the centre huge financial aid by way of development grants which is relatively more than the tax sharing revenues they get by virtue of the Finance Commission's recommendation, can or has in any way jeopardised the constitutional position, powers and functions of the Finance Commission. It would be the height of administrative absurdity and constitutional mimickry to say that the flow of more financial aid from the centre, on the basis of the Planning Commission's recommendations, to the states whiles

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38 Ibid. p.8.
or undermines the role of the Finance Commission. Neither this nor the justifying explanation that is sought to be offered in favour of this proposal would seem to carry any conviction. It is only a figment of imagination to hold that the constitutional authority and role of the Finance Commission is whittled or considerably narrowed down by the advent of the Planning Commission and its role in the Planning process and the resultant impact on the federal system of India.\(^{39}\) Granting that the proposal of the critics is not bereft of truth or far from reality a searching question that crops up conspicuously in this connection is that if the Finance Commission were empowered, as has been suggested, to perform the function of recommending the size of development grants to be given by the Centre to the states would it result in securing to the Finance Commission a role which, as appears to have been made out by the proposal of the critics, has been denied to it by the advent and role of the Planning Commission in the process of development planning and undo the unmitigating evils of planning on the Indian federal system?

The advantages of this proposal may seem to have been actuated by a feeling that in the matter of giving development aid, if the Centre were placed under a constitutional obligation to give such grants and the states entitled as a matter of constitutional right to

\(^{39}\) Dov. Veda. p. 207
receive the same, this would reverse the process of constitutionalism in the Indian federal system. This may look laudable but only on the surface. What is important to realise is that the state's partial dependence on the centre for financial assistance is inherent in the Indian Constitutional System. 40

This has been further aggravated by the advent of development planning necessitating huge public expenditure. Planning is a dynamic process entailing huge financial outlay in proportion to the magnitude of ambitious nation-building activities undertaken. This will go on changing correspondingly as time passes. Imposing a constitutional obligation on the centre and conferring right on the states to secure development grant may be ideal and appreciable in theory. But when it comes down to the plans of realities-political, administrative and economic, it will be found that it will not be a very easily workable proposition. 41 The dynamics of development demands considerable flexibility and discretion to meet any eventualities and contingencies that might arise in accomplishing the targets of planning. Could this be ensured if the Finance Commission were entrusted with the

40. This is evident throughout the constitutional provisions governing the Centre-State Financial Relations in India, viz. Arts. 268-281, 285-289, 292 and 293.

function of considering and suggesting the development grants as well to the states? A question like this needs probe into the constitutional implications of the proposal as well as its crippling effects on the functional efficacy of the Planning Commission. Under Art. 280 as it stands to-day the Finance Commission cannot undertake the function of recommending to the Centre the size of development grants to be given to the states. Whatever development grants the centre has been giving to the States, it has been doing so by resorting Art. 282 which provides for discretionary grants. Unless Art. 282 is amended suitably so as to bring the grants envisaged in this Article within the purview of the Finance Commission, it cannot recommend the size of development grants to be given to the states. Art. 282 in its present form has flexibility in it. It is this constitutional flexibility that has stood the centre in good stead to dole out huge financial aid to the states. It is the authority of this Article which has enabled the centre to use its discretion in an elastic manner to meet the state's growing financial requirements necessitated by development planning. Thus both Art. 280 and 282 need appropriate modifications. Should the Finance Commission be authorised to consider and suggest the size of development grants as well to be given to the states? If the bone of contention of the critics is that under the impact of planning aggravated by the Planning
Commission's increasingly important role in recommending the size of development grants to the states has invariably led to the distortion of federalism they have proposed to make the Finance Commission responsible for suggesting the size of development grants too, this is not the suitable remedy for checkmating the distortion of federation in India. If the provision for discretionary grants under Art. 282 were brought within the purview of the Finance Commission by means of suitable constitutional amendment, this will not fail to have repercussion on the role of the Planning Commission and National Development Council. In fact, whatever influence, prestige and importance that these bodies have been enjoying in the process of development planning it is by the influence they have brought to bear on the union government in giving development grants to the states. The moment the Planning Commission is divested of this important function, this is bound to cripple its role in the planning process, and it is not certain if this change brings about any corresponding improvement in the role of the Finance Commission to preserve intact the federal system without this being distorted.
The financial arrangements between the Centre and States as worked out by the Constitution consists of four elements:

(a) Independent sources of taxes assigned to the Centre and States respectively.
(b) Obligatory grants by the Centre to the States.
(c) Distribution of revenues between the Centre and States, and
(d) Discretionary grants by the Centre to the State.

The separate sources of taxes that are allotted to the Centre and States respectively is in conformity with, and influenced by the principle of independence which should regulate the financial arrangements between the Centre and States. To this extent the principle of independence has been steadily followed. If, in spite of this, the states have complained that they have not been given adequate sources of revenue, this is caused not by failure to follow

The principle of independence in regulating the financial arrangement, particularly in respect of the first ingredient, but to a great extent by the States themselves who have felt shy to utilise effectively, skillfully, and imaginatively in a business like manner their sources of taxation.

The state governments because of their proximity to the people and particularly the rural sector are hesitant to spread their fiscal net to harness resources to the maximum rest they mortgage their political future. Added to this, financial probity, economy, discipline and faithfulness are not of a very high order in the state's public expenditure. The gloomy and sordid side of the state's public finance is a trenchant factor to be considered in understanding the crux of the matter as regards the financial solvency of the states.44

Obligatory grants by the centre to the states under Art.275 do not constitute a threat to the principle of independence. Because giving these grants to the state by the centre is a constitutional obligation on the centre. It is in fulfilment of its constitutional obligation to the states the centre pays such grants to the states. Any failure on the part of the centre to respect its constitutional obligations amounts to a failure to discharge a constitutional function enjoined upon the centre in which event the affected parties are not helpless or constitutionally indignant to

question the same in a court of law. For reasons obvious, obligatory grants by the centre will not and cannot be said to be a threat to the principle of independence constituting the bedrock of the federal financial arrangement. This explanation or reasoning does not hold good in the case of discretionary grants. Public expenditure on an unprecedented scale necessitated by the advent of developmental planning has accelerated by all leaps and bounds the scope for discretionary grants by the centre to the states. 45 This is a very important factor but not the only factor responsible for expanding the scope of, and need for discretionary grants by the centre. But there are certain other factors such as damage caused by floods, famine and scarcity conditions caused by drought and political considerations 46 inflating the state's public expenditure to the point straining the financial health considerably. These are some of the trenchant factors responsible for obliging the already needy states to view with each other in creating a situation for making the centre to dole out its assistance in the form of discretionary grants. Discretionary grant by its very nature and effect is not congenial to preserve intact the principle of independence. The threat posed by discretionary grants to the principle of independence is having two


46. Ibid.
dimensions. When the centre which gives discretionary grants to the needy states, if both of them happened to be ruled by the same political party, the threat and damage caused by discretionary grants to the principle of independence will not be deemed by the states concerned to be so severe or irreparable as both the partners are ruled by the same political party. But when the centre and the states concerned are ruled by different political parties with rival political ideologies and programmes, the threat caused by the flow of discretionary grants is considered to be too much. Whatever may be the political situation under which the discretionary grant is poured out from the centre to the states, it cannot be denied that its effect will not be wholesome on the principle of independence. There is provision for the centre to give grants to the jute growing states in lieu of export duty on jute and jute products. This should not be mistaken for or identified with the discretionary grant as this latter is within the political discretion of the centre. Nor this grant can be equated with the obligatory grants. But the specific grant

47. Bengal's plea for grants may become an issue - Times of India, 27 November, 1980.

48. Ibid.

49. Art. 273 makes provision for the grant to the jute growing states in lieu of export duty on jute and jute products.
given by the centre to the jute growing states is a constitutional duty devolves upon the centre which cannot be ignored. Thus the specific grant by the centre to the jute growing states will not affect in any way the principle of independence.

Distribution of revenues constitutes a very important part of the financial arrangement that exists between the Union and the States. No government can discharge its obligations to the people properly unless it has adequate finance. The essence of federation is distribution of functions and no system of federation can be successful unless both the Union and the states have at their disposal adequate financial resources to enable them to discharge their respective responsibilities under the constitution. As explained by the Supreme Court of India in Coffee Board V.C.T.O. 50

"Sources of revenue which have been allocated to the Union are not meant entirely for the purposes of the Union but have to be distributed according to the principles laid down by Parliamentary Legislation as contemplated by the Articles aforesaid. Thus all the taxes and duties levied by the Union — do not form part of the consolidated Fund of India but many of these taxes and duties are distributed amongst the

states and form part of the consolidated Fund of the States. Even those taxes and duties which constitute the consolidated Fund of India may be used for the purposes of supplementing the revenues of the States in accordance with their needs. The question of distributing of aforesaid taxes and duties amongst the states and principles governing them, as also the principles governing grants-in-aid ... are matters which are to be decided by a high powered Finance Commission.

In the distribution of revenues there are four items:

(1) duties levied by the Union but collected and appropriated by the states;

(ii) taxes levied and collected by the centre but assigned to the states;

(iii) taxes levied and collected by the Union and distributed between the Union and States, and

(iv) taxes which are levied and collected by the Union and may be distributed between the Union and the States.

In this category also, Art. 276 authorises the States to levy taxes on professions, trades, calling and
employments notwithstanding the income tax levied and collected by the centre. Both in terms of their implications and tenor, Arts. 268, 269, 270 and 272 and 276 dealing with the aforesaid items in the distribution of revenues are not inimical or averse to the principle of independence which could tamper the financial arrangement that should exist between the union and the States. Even the working of the constitution since 1950 provides no less proof to show that the principle of independence was not lost sight of in designing and reconstructing the centre-state financial arrangement.

The principles of adequacy and stability are as important as the principle of independence underlying the financial arrangement. Adequacy is a relative notion. What was considered adequate at one time might no longer remain so with the passage of time. It is no gainsaying the fact that the constitution makers did not fail to give due weight to the principle of adequacy in reconstructing the centre-state financial arrangement. But of late the states have been very vociferous in reiterating repeatedly that they have not been given adequate resources commensurate with their growing responsibilities and requirements. Hence this demand for recasting the relevant

provisions in the Constitution to enable the states to have adequate financial resources. For example, the 1977 West Bengal Memorandum has demanded that 75 of the total revenue raised by the centre be given to the states. \(^{52}\) Similarly, the Rajamanner Committee\(^ {53}\), devoting a full chapter (Chap. -V) on Financial relations has observed that the scheme of chapter I of part XII of the constitution was "not fair to the States". \(^{53}\) It forced them to depend largely upon discretionary grants, or also overdrafts.

While rejecting the demand of West Bengal the Seventh Finance Commission Stated \(^ {54}\):

"From the memoranda of these states we are not able to make out how this percentage has been arrived at and law it has been estimated by them that the balance of central revenues would be adequate for meeting the inescapable expenditure of the central Government. The West Bengal memorandum does not spell out the views of the state government on the principles of distribution of proceeds of income tax and excise among the States. Therefore, it does

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52. Memorandum on CSR., Government of West Bengal. p. 4.
not appear that the state's demand for 75% of
the Central Revenue for the state is based on any
estimation of the needs of the States vis-a-vis
the needs of the centre. Nor can we appreciate
how such a demand is in consonance with the
provisions of the constitution. We are unable
to agree with their approach.

A glance at the entries from 45 to 62 and 62A in
the state list (Qc VII schedule) will show that the
imperative need of adequacy was given due consideration in
reconstructing the centre-state financial arrangement.
While reiterating the importance given to the principle of
adequacy it is not intended to gloss over or brush aside
the force and cogency inherent in the state's complaint 55
that their financial resources are inadequate and consequently
they have found it difficult to come with their ever-
increasing responsibilities and needs and requirements.
Although it cannot be said with any courage of conviction
and robust confidence that the constitution has endowed the
states with ample and adequate resources to enable them to
meet their requirements for all times to come, which is an
unattainable goal, nothing comes in the way of reaffirming
that the constitution has not left the states financially
in lurch and forced them to suffer from straightened

financial position. It is undesirable and unrealistic to throw blame on the constitution or the centre as solely responsible for the inadequacy from which the states have suffered or have been suffering in financial resources. In this matter, a far greater responsibility lies with the states themselves. It behoves that the states should own their moral responsibility and financial culpability which is in a very considerable measure responsible for their financial inadequacy. Considering the extent to which the states are responsible for their financial inadequacy, they are not entitled to feel as if they were innocent lambs threatened by a wolf like centre in whom the constitution has concentrated greater and perennial financial resources. Constitution has not denied to the states their due or legitimate share in the allocation of financial resources. But the states have been markedly lethargic and unusually unenterprising in harnessing to the maximum whatever sources of financial resources allotted to them. The yield from the land revenue decreased over the years, and in certain states the old slogan—dusted agrarian welfare programme withdrawn as well. This was done without imposition of any new levies to make up the revenue loss ....... In no state the tax (i.e. agricultural income tax) was ever administered.

In view of the state's complaints that they have been assigned comparatively inelastic taxing powers, it will not be out of place to mention that recently the scope of sale-tax, tax on motor vehicles and tax on trades, professions and callings has been expanded by law - sale-tax by a constitutional amendment, and the other two by judicial interpretation. By the 46th Amendment, 1983, the definition of sale- has been expanded to include, inter alia, works, contracts and hire purchase transaction, obcourse subject to Parliamentary restriction.

As far as tax on motor vehicle is concerned, it is subject to the restriction that the tax should be 'compensatory' in nature. The Supreme Court in Automobile Transport Ltd. vs State of Rajasthan,\textsuperscript{57} has measured only two types of expenditure on roads - Their maintenance and their construction - against the total receipt from the tax. The tax was regarded as compensatory if the expenditure was more than the receipts. The court, however, in Malwa Bus Service v. State of Punjab\textsuperscript{58} added other items of roads and permitted to carry forward of surplus in any year to the next year. Thus, failure of the States is to a very great extent responsible for their financial inadequacy. The states should not deny that their share is greater than any other factor in this behalf.

\textsuperscript{58} Decided on 28-4-1983.
Stability is equally important as independence and adequacy. Stability in the financial sphere is a factor of considerable importance in determining the degree of federalism, and the extent of autonomy of the constituent states. But stability in the financial sphere in a federal set up depends in a very large measure upon the extent to which the principles of independence and adequacy have been followed in reconstructing the financial arrangement. There may be independence and adequacy in the financial sphere but still stability may be eluded. But there cannot be stability in the absence of the observance of the principles of independence and adequacy. Stability in the financial sphere of the states is determined by the adequate finance obtained by the states from the independent sources of revenues assigned to them by the Constitution. Thus the extent to which it would be possible to obtain or ensure the principles of adequacy and stability in financial matters for the states and their financial relations with the centre depends on the degree in which the principle of independence has been scrupulously followed in the allocation of revenue to the states.


60. Ibid.
To examine whether this principle of independence has been duly observed in shaping the financial arrangement between the centre and the states it is necessary to find out how much of their revenues the states get and from what sources. There are two such main sources; revenues obtained from the independent sources of taxes and revenues assigned to the states; and contributions from the centre to the states. A number of independent sources of revenues and taxes assigned to the states\(^{61}\) has enabled the states to derive a very large part of their revenues. In deriving their revenue from the independent sources of taxes and revenues the states, subject to the constitutional requirements, are not at the mercy of the centre. The very fact that the states are independent of the centre in deriving a very large part of their revenues from the independent sources assigned to them constitutionally establishes that the principle of independence has been duly observed in the matter of shaping the centre-state financial relations and distribution of financial powers between the centre and states. In this sense and to this extent the revenues derived by the states from the independent sources of finance revenue assigned to them constitute the kernel of the principle of independence. It is also important

\(^{61}\text{Vide entries 45 to 62 and 62A of list II of the VIIth schedule.}\)
to note that not a small part of the revenue/ finances of the states comes from contribution. In this respect, one can see the impact of the experience of the U.S.A. Switzerland and Germany. Consequently, in India the centre is also not placed at the mercy of states by making them to give their financial contributions to the centre. The reverse is true in the Indian case as the financial contributions made by the constituent units to the centre led to the devastating effect of emasculating the latter. If the financial contributions by the constituent units to the centre caused irreparable havoc in the case of such countries as the U.S.A., Switzerland and Germany, it could be asked, not unfairly, that would not the financial contributions by the centre to the constituent units in India lead to similar unpleasant and ruinous effects?

It is difficult to deny the force, logic and cogency underlying this pertinent question. It is important to note that under the Indian constitutional system, there is provision for two kinds of contribution: Obligatory and optional, constituting a very important part of federal finance in India. Of these two types of contribution,

62. Sharma, J.N. - The Union and the States - A study in Fiscal Federalism - p. 46. The federal Government has exclusive jurisdiction only over custom, while in other fields of taxation, it has concurrent powers with the States.
obligatory contribution will not pose any threat to or 
endanger the principle of independence, As long as it is 
constitutionally obligatory on the part of the centre to 
make certain financial contributions to the states, 
neither the centre by virtue of making such contributions 
can arrogate itself to a position of superiority to ride 
roughshod over the states nor the recipient states can be 
humbled or cowed down. But the situation is entirely 
different in the case of optional or discretionary grants. 
The optional or discretionary grants are fraught with 
dangers as far as the principle of independence is concerned. 
In the post-independence period due to a variety of factors 
the scope for optional or discretionary grants has grown by 
all leaps and bounds. In fact, this has grown like a 
frankenstein monster. This has been rendered inevitable, 
among others, by the impact of development planning on 
the political and administrative processes of the country. 63 
Centralised planning has become unavoidable in the 
developing world. There is no short cut to it as far as 
India is concerned. Centralised planning and federalism 
of the classical type developed on the assumptions of 
autonomy of the constituent units - the core of federalism 
and balance of authority between the federal and state 
governments hardly go together. 64 Wherever or in whichever 
federation economic planning in some form or other, let 

64. Ibid.
alone the Indian type, has been resorted to it, has unleashed forces and created a strange situation that have necessitated central intervention in the spheres that were hitherto earmarked for the states and the resultant increase in the scope and dimension of optional or discretionary grants. Although the development plans are formulated by the planning Commission, at the centre, the implementation of such plans has become the joint responsibility of the centre and states. The states' responsibility for implementing the plans has imposed extra-ordinary burdens on their financial resources. To save the needy states from this unusual financial males the centre has been obliged to allot huge funds to the states which has resulted in expanding in extraordinary proportions the scope of discretionary grants. Unmindful of the size of their resources which they have not done their best to expand steadily, the states, actuated by the unquenchable thirst for the rapid development of their respective regions, have vied with each other in pressing the central authorities and the planning commission for the allotment of more and more ambitious and prestigious projects and plans to their regions. The central authorities have not succeeded in dissuading the states from making such unrealistic and tall claims. After having made such demands and succeeded in

obtaining the same, the states have unwittingly thrown themselves to be at the financial mercy of the centre and consequently contributed to the growth in the scope and dimensions of discretionary grant which is not congenial from the viewpoint of the principle of independence underlying the scheme of federal finance. Thus for whatever danger and challenges posed by the everexpanding discretionary grants from the centre to the states, the states should be squarely blamed. In this respect the states are not above board and neither the centre nor the constitution alone is to be blamed. It is preposterous to think that the inclusion in the constitution of provision for discretionary grants is inimical to the cause of federalism or state's fiscal autonomy. India's experience gathered in the context of the implementation of the development plans has shown demonstrably that it was the presence of provision like this in the constitution that rendered possible for the centre to dole out sizeable grants to the states to enable them to go ahead in implementing the plans. But for the huge funds channeled by the centre through the conduit pipe of discretionary grants, the states would not have been able to implement the plans. Whether the centre has used this power judiciously, impartially and discretely is a separate question. What is important to

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66. Ibid.
emphasise is that the financial indiscipline, fiscal permissiveness and administrative inaptitude of the states are responsible in a considerable measure for the discretionary grants to assume alarming proportions. Thus it cannot be said that the principles of independence, adequacy and stability have not been given adequate consideration in working out the centre-state financial arrangement. What deserves to be mentioned is that neither the states because of the ineffective and unsatisfactory management of their finances have been able to co-operate with the centre in ensuring the observance of these principles nor the centre has been able to whip up the administratively lethargic and financially indisciplined states to live up to these principles.

F. CRITICAL APPRAISAL

The Constitution has not chosen to deviate deliberately from the principles of independence, adequacy and stability. However, to be in conformity with these principles, the constitution has not followed the modus vivendi of allowing the centre and states to operate simultaneously the entire field of taxation. In fact, such a course would be undesirable, impracticable and most unrealistic. The observance of these principles in shaping
the centre-state financial arrangement is not the sole responsibility of the federal centre but the states too. The states should by husbanding and managing their finances in an efficient, imaginative and purposeful manner make these principles a fait accompli. But it is the inefficient and maladroit manner in which the states have managed their finances that led to the distortion and mutilation of these principles. This should not warrant the conclusion that in the process the principles of independence has been sought to be blurred if not obliterated. The constitution has followed the established practice of providing the centre and states respectively with independent revenue raising and taxation powers. This is done by following the method of authorising the centre to raise revenue from all such items and sources national in character and scope, and the states in respect of such items that are regional or state in scope. But a demarcation like this in the sphere of finance cannot be effected with mathematical accuracy and scientific precision. The logical corollary of this allocation of financial powers between the centre and the states is that both have their separate administrative apparatus for collecting their revenues and taxes.

This arrangement has become inevitable in view of the fact that in respect of constitutional authority given to the centre for raising its revenues and collecting taxes if the states were held to be administratively
responsible for collecting the same and vice versa it
would have resulted in creating numerous difficulties and
bottle necks. Any such divorce between constitutional
authority and administrative responsibility would have done
more harm to the federal financial arrangement. Thus both
the federal and state governments having their own administrative
apparatus, for collecting their revenues and levies for
which they are constitutionally responsible, is in conformity
with the mechanism of federal government. Barring income
tax and corporation tax which are levied and collected by
the Union Government but the net proceeds of which are
distributed between the centre and states in accordance
with (or in the light of) the proposals or recommendations of
the Finance Commission, the constitution has assigned to
both the centre and the states respectively independent:
sources of revenue and taxation powers. It is not enough
if the constitution allocates revenues and taxation powers
separately to the centre and the states but to carry this
principle to its logical conclusion; it is important that
the centre and the states should be given both the legislative
and administrative authority they need for exercising
effectively and purposefully their respective fiscal powers
and enjoy the fruits of the same. If they were given only
one type of authority, either legislative or administrative
and denied of the other, this would create a very anomalous situation and irksome position and render autonomy a farce. The Indian Constitution has been by conferring both the legislative and administrative authority upon the centre and the states to enable them to exercise effectively their respective fiscal powers. By effecting this the constitution has not failed to do its best to prevent the cause of fiscal autonomy from being trampled over.