COOPERATIVE FEDERALISM

From Rhetoric to Reality

Vidhi

Centre For Legal Policy

BETTER LAWS. BETTER GOVERNANCE

COOPERATIVE FEDERALISM

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The Vidhi Centre for Legal Policy
is an independent think-tank doing legal research
and assisting government in making better laws.

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FOREWORD

The concept of cooperative federalism gained currency during the 1930s in the United States of America. In a strict sense, it would appear that the word `cooperative' is redundant as it is the basic postulate in political theory of federalism that two or more sovereigns surrender part of their sovereignty to work together for common good. Cooperative federalism envisages that national and state agencies undertake government functions jointly rather than exclusively. The nation and states would share power without power being concentrated at any government level or in any agency. The advantage of this system is that distribution of responsibilities gives people and groups access to many avenues of influence which may otherwise be inaccessible. This concept became very important in the United States of America as the American Constitution recognizes that independent states have come together to establish one nation as evidenced by the location of residuary powers under that Constitution with the states.

Even in a truly federal State, there may be several objectives to be achieved that may have political importance or ramifications throughout the country. It would be practically impossible for the federal government to achieve the national objectives without active cooperation from the state governments. It is thus crucial that the federal and state governments are on the same page and on the same wavelength.

The concept of cooperative federalism was not important in India during the halcyon days of single party domination of Parliament and State legislatures as it was easy to implement national policies through the party mechanism. With the advent of multi-party system and coalition governments — since the States and the Centre are no longer ruled by the same party, giving rise to considerable tension between the States and Centre — the idea of cooperative federalism has become crucial. Even on several important national issues, the Centre and the States do not appear to have a consensus, leading to avoidable expenditure of time, finances and national energy.

The concept of cooperative federalism is critical to our national interest in the current scenario. The national objectives must be clearly identified and defined. With regard to such national objectives, there should be no reason for dissension by the States which must necessarily act in their own fields with the object of achieving those national goals. The Centre should not adopt a Big Brother policy vis-à-vis States but must take the role of facilitator with two way communication.

Communications, inter-state commerce, e-commerce, taxation, security and host of such national objectives get derailed when state interest predominates. The Centre and the States must devise a delivery system for implementation of federal programmes by motivating compliance from those concerned in the States. It is no time for the titans to clash, but to cooperate in national interest.

Cooperative federalism is an idea whose time has come!

Mumbai,
September 6, 2015
B.N. SRIKRISHNA

INTRODUCTION

THOUGHTS ON COOPERATIVE FEDERALISM

Cooperative federalism has been characterised as one of the fuzziest topics in political theory. While it is easy enough to point to examples of States and the Centre cooperating, a normative approach, especially in the Indian context, usually amounts to little more than exhortations to 'get along better' in the national interest (Rao, 2005). Sceptics, therefore, deem it more of a political slogan than a constitutional doctrine.

Although the term has been floating about the Indian polity for decades, it has gained new life in the past year. The new Central Government is committed to the idea, and steps such as the dismantling of the Planning Commission and the increased devolution of taxes to States have been held up as demonstrations of this commitment. Since then, cooperative federalism has been used as a prop by both Central and State governments in contexts as varied as urban housing, labour welfare and the celebration of International Yoga Day.

So far, the concrete steps taken by the Centre may validly be seen as devolution of greater financial autonomy to States. But is this all that cooperative federalism entails, or are there bigger prescriptions that the idea encapsulates? How does the Centre play a more effective role in ensuring cooperation? What of the concomitant responsibilities of States? Are India's institutions, at various levels of government, designed to cooperate effectively?

An attempt to pin down the intellectual roots of the phrase led to a study of the United States polity in the 1950s, when the phrase was used by political scientists to describe the shift from 'dual federalism' (where each state was seen as an independent sovereign unit) to more inter-dependent governance that developed with increasing complexity in the early 20th century (Elazar, 1991). This shift in the United States, however, meant that 'cooperative federalism' represented a move away from complete state autonomy, rather than towards it. This fundamental difference in context between the two countries means that the theoretical work on this issue from the United States cannot be usefully relied on in arriving at an understanding of cooperative federalism in India.

In Australia, the phrase has been used to describe a "range of mechanisms to manage the conflict, duplication, costs and inefficiencies that can arise in the operation of a Federation." (French, 2005) This, while providing some direction, is still fairly general. In India, the jurist MP Jain wrote in 1968:

"Though the Constitution provides adequate powers to the Centre to fulfil its role, yet, in actual practice, the Centre can maintain its dynamism and initiative not through a show of its powers — which should be exercised only as a last resort in a demonstrable necessity — but on the cooperation of the States secured through the process of discussion, persuasion and compromises. All governments have to appreciate the essential point that they are not independent but interdependent, that they should act not at cross-purposes but in union for the maximisation of the common good." (Jain, 1968)

This echoes the stance taken by the government today, but still remains in the domain of broad prescription. What, then, will make 'cooperative federalism' concrete? This Briefing Book chooses to focus on specific practices of the Indian federation to try and arrive at normative solutions that take into account a cooperative approach. It looks at twenty issues of contemporary relevance across four themes derived from constitutional values:

- 'Unity and Integrity of the Nation' — issues relating to statehood and security
- 'Ideals and Institutions' — administrative interactions within the federal structure
- 'The Operation of the Economic System' — matters of public finance and financial market regulation, and
- 'The Public Trust' — sharing and preservation of natural resources.

Under these themes, the selection of issues and solutions in the Book is driven by contemporary relevance and feasibility. Specifically, those issues are selected where the interests of the Centre, States, or the third tier, are at conflict with one another. Therefore, proposals such as overhauling the Seventh Schedule, or altering emergency powers in the Constitution, although of deep relevance to federalism, have not been considered.

Our assertion in this Book is that for a federation where the units are incentivised to cooperate with each other, individualised solutions must be put forward in situations of conflict, keeping the broad normative framework of cooperative federalism in mind. This is what this Book takes a step towards. It outlines the federal challenge for each issue, and proposes solutions that fall into one of the following broad categories:

- Clarify demarcation of powers in light of new developments
- Devolve power to States or the third tier, but with attendant attention to capacity building
- Incentivise cooperation in inter-government relations
- Guide discretionary powers which are leading to conflict

By proposing these solutions, we hope this Briefing Book helps in sparking off a more intensive discussion on the meaning of cooperative federalism. If it can connect the rhetoric that has dominated the discussion so far to the reality of the federal conflicts facing the country today, it will have served its purpose.

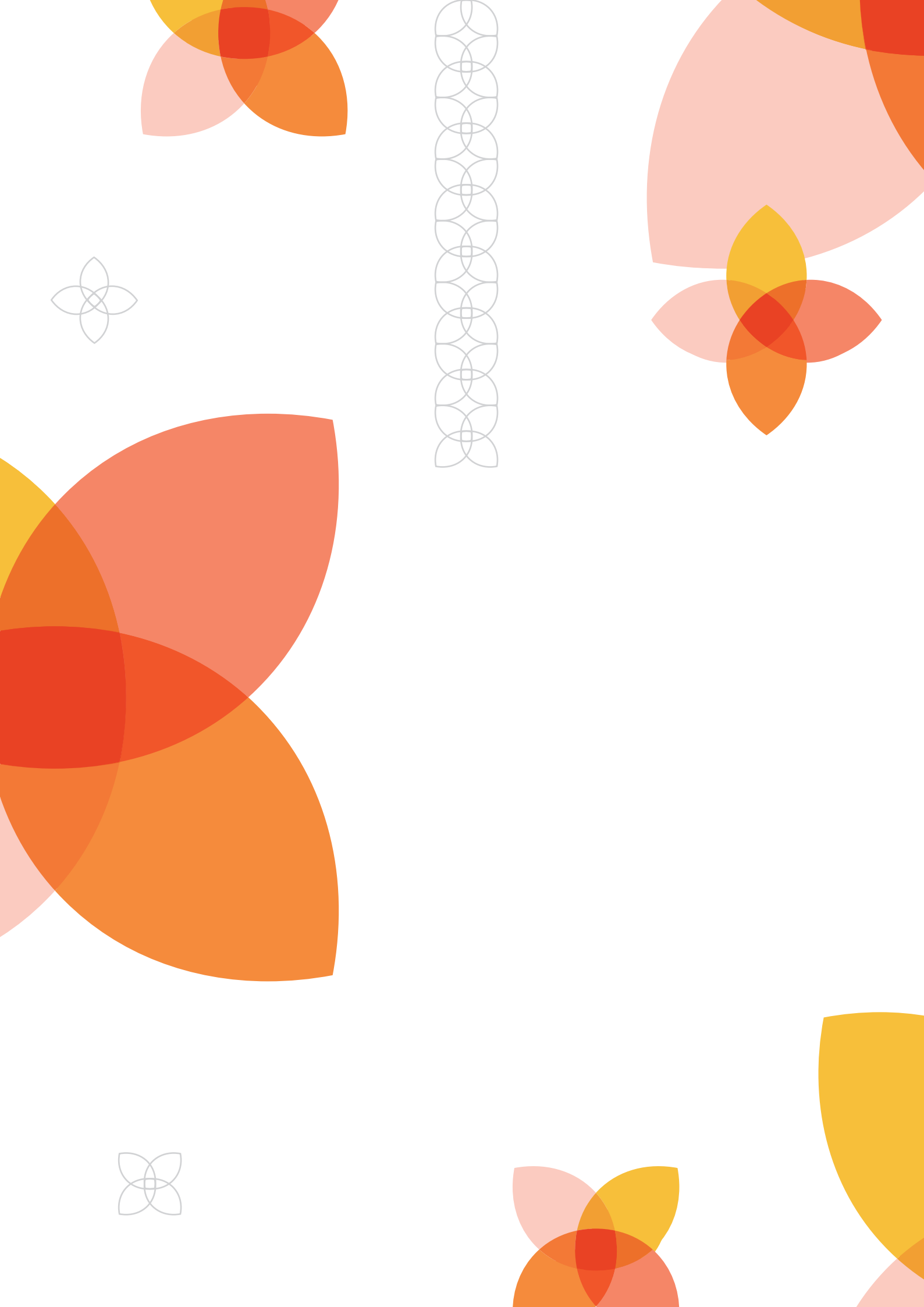

TABLE OF CONTENTS

Introduction: Thoughts on Cooperative Federalism

1. 'Unity and Integrity of the Nation' // 10

Forming New States // 12
Redesigning Delhi's Governance // 13
Investigating Terror Cases // 14
Developing Backward Areas // 15

2. 'Ideals and Institutions' // 16

Strengthening Inter-State Bodies // 18
Ensuring Governors' Independence // 19
Reviving the Autonomy of High Courts // 20
Reducing Sub-National Variations in the NREGS // 21

3. 'The Operation Of The Economic System' // 22

Devolving Funds to Local Bodies // 24
Strengthening the GST Council // 25
Conceptualising E-Commerce Laws // 26
Supervising Urban Co-operative Banks // 27
Improving the Regulation of Chit-Funds // 28
Regulating Micro-Finance // 29

4. 'The Public Trust' // 30

Federalising Land Acquisition Legislation // 32
Strengthening the Environment Impact Assessment Process // 33
Tightening Forest Diversion and Compensatory Afforestation Processes // 34
Overhauling Adjudication of Inter-State River Water Disputes // 35
Unlocking the Power Sector // 36
Streamlining the Functioning of District Mineral Foundations // 37

References // 38

Acknowledgments // 40

UNITY AND INTEGRITY OF THE NATION

STATEHOOD & SECURITY

Perusing the Constituent Assembly Debates in search of an approach towards federalism, one finds repeated concern, almost uniformly across members, about the need for a strong Centre. The more Centre-oriented members were of the belief that most of the new nation's goals — from planned economic development, regulation of industry and the economy under stress, protection from foreign aggression, and a unified, effective administration — could be fulfilled only through a strong Centre. This was influenced in great part by the traumatic legacy of partition. Even when members spoke up about the interests of the provinces, the notion of 'unity and integrity of the nation' seemed to trump other concerns.

It is this anxiety regarding the notion of 'integrity' that led to the Centre retaining sole power to create or destroy States in the Union. This was a departure from the constitutions of most federal systems, which either require the consent of the State unit concerned, or require a special majority in the upper house, in order to preserve the sanctity of the individual units of the federation. The Indian method, introduced after considerable debate, has been witness to prolonged political struggles before new States are formed. While full statehood, once achieved, resolves all constitutional questions, partial ad hoc solutions, such as the one adopted for the National Capital Territory of Delhi, continue to generate questions and controversy. The latest chapters in this saga, on Telangana and Delhi, have prompted a fresh look at the issue of formation of States in light of the new slogan of cooperative federalism.

In recent times, the notion of preserving the unity and integrity of the nation has also been used for attempts to concentrate powers of criminal prosecution in the Centre to combat the threat of terrorism. In fact, this phrase is specifically used to describe acts of terrorism in the law. This is perhaps what has led to political scientists studying federalism to identify secession and cross-border terrorism as the two most urgent challenges that directly pit Centre and State interests against each other, while rejecting this binary in most other matters. (Varshney, 2013)

In India, unlike other federal countries, constitutionally there is no allowance for a 'federal crime' that may be investigated at the sole discretion of federal agencies. While criminal law is a Concurrent List item, public order and police are in the State List. Therefore, while the power of the Centre to legislate on offences related to terrorism is now beyond dispute, its arguably concomitant power to investigate such offences has been the subject of intense debate, particularly with the establishment of the National Investigation Agency, and the intermittent proposal for a National Counter-Terrorism Centre. Meanwhile, States have passed or attempted to pass laws that have been characterised as encroachments on the Centre's powers to legislate on terror offences — the Gujarat Control of Terrorism and Organised Crime Act, 2015 being the most recent example. States and the Centre have over the last one and a half decades repeatedly locked heads on both counts — with States attempting to legislate on terror offences, and the Centre attempting to investigate them.

Does 'cooperative federalism' offer a way forward? For a phrase that has been used in the context of almost every conceivable Centre-State debate, it is telling to note that official statements have failed to make the connection between cooperative federalism and the recent tussle over Delhi. One can see this as revealing the limitations of the approach, in that it will recede when confronted by major political battles. Sceptics, on the other hand, may see this as evidence of the inherently rhetorical nature of the concept.

As we outlined in the Introduction, this Briefing Book takes the approach that for cooperative federalism to work in practice, an individualised approach must be taken for the most pressing concerns in Centre-State relations. Progress in the resolution of such disputes, or in the restricting of systems with greater coordination in mind will ultimately further the goal of cooperative federalism. This section, therefore, looks at contemporary issues of statehood and security against this backdrop.

FORMING NEW STATES

THE CONFLICT

One of the chief concerns in the design of federal governments the world over has been to allow the expression of different ethnic identities through smaller, more accountable political units. In India, this concern has taken the shape of the highly charged debate around the formation of new States.

Under Article 3 of the Constitution, a Union Bill proposing reorganisation must be sent to the concerned State Legislature for 'expressing its views' within a specified period. However, its views need not be followed by Parliament. Moreover, the Supreme Court has adopted a literal interpretation of Article 3 holding that there was no requirement that an amendment to a Bill forming a new State should also be referred to the State Legislature concerned.

Evidently, the views of the State Legislative Assembly have no binding effect on the Parliament's decision to form a new State. The first States Reorganisation Commission (1953-1955) articulated the principle that the reorganisation of States must be done only if there is on the whole a 'balance of advantage' in any change. This balance, however, is hard to determine because no two demands for reorganisation of State boundaries are based on similar facts and circumstances. Moreover, there are no established principles which determine when the boundary of a State needs to be altered, or what considerations can legitimately trigger the process of formation of new States.

As a result, short-term political gains for the political party at the Centre, may dictate the process of formation of States. This becomes problematic in situations like the Andhra Pradesh Reorganisation Bill, 2013, which was decisively rejected by the Andhra Pradesh Legislative Assembly and Council, but where the Parliament went ahead with the formation of the State of Telangana. This flies in the face of the fact that even though India's federal structure has a strong centralising predisposition, over the years, the Centre and the States are being increasingly viewed as coordinate entities.

PROPOSED APPROACH

The Constituent Assembly debated the current Article 3 at length, ultimately leaving the decision-making power to the Parliament because a breakaway State's concerns would otherwise not surface in the concerned State Legislature.

By allowing the Union to redraw State boundaries, Article 3 has successfully implemented India's 'holding together' federalism. Amending Article 3 shall therefore not be an appropriate response to address this situation. However, two elements in the current process require change. First, the constitutional scheme needs to be reworked to ensure that Parliament takes a greater measure of consideration of the views of the State Legislative Assemblies. Second, Parliament needs to adhere to certain principles while voting upon a reorganisation Bill.

To establish such principles, a body in the nature of a second States Reorganisation Commission (SRC) can be formulated under the Constitution. The SRC can act as a body which considers compelling questions regarding the formation of new States, such as the feasibility of forming smaller States for better administrative governance, the significance of local government and concerned institutions within the State, and the socio-cultural impact on the peoples of the States that are being divided. The SRC may also give independent recommendations to Parliament with regard to specific demands for formation of new States.

Together, these recommendations will help take into account the interests of all groups — those in the currently existing States, as well as those who wish to form part of the proposed one.

IMPLEMENTATION

In order to implement the first element, Parliament should be required to adequately take into consideration the views of the State Legislative Assembly, demonstrating proper application of mind. As a matter of convention, so as to accord a purposive interpretation to Article 3, Parliament should give reasons as to why such views were accepted or rejected.

With respect to the SRC, this should be a recommendatory body which is mandatorily constituted after certain specified time periods, and which has a fixed tenure, along the lines of the Finance Commission. The Parliament would also have to seriously deliberate over the nature of this body, its proposed functioning, terms of reference, manner of giving advice, its secretariat, and, most importantly, the expert knowledge of the persons manning this body.

The constitutional scheme needs to be reworked to ensure that Parliament takes a greater measure of consideration of the views of the State Legislative Assemblies on the question of state formation.

REDESIGNING DELHI'S GOVERNANCE

THE CONFLICT

The high-decibel altercation between the Chief Minister of Delhi and its Lieutenant Governor over the power to appoint bureaucrats masks a fundamental question — who should have the last word on governance in Delhi — the Government of Delhi or the Government of India (GOI)?

This is not a new question — the Constituent Assembly witnessed a contested discussion, with Deshbandhu Gupta supporting responsible government, and BR Ambedkar favouring greater control by the GOI owing to Delhi's status as the national capital. This was replayed in 1956 with the States Reorganisation Commission concluding that Delhi should not be a State at all. Delhi, till then a Part C State, was converted into a Union Territory with a Municipal Corporation. The burgeoning population and expanse of Delhi led to a rethink of this constitutional arrangement in 1991. Article 239AA represented a new compromise with an elected Legislature having powers over all, save a few State List subjects. Ultimate authority however remained with GOI which could override the Delhi Government on any subject. 2015 signals the fourth episode of this constitutional ping-pong, that has thus far been woefully shorn of clear principle.

PROPOSED APPROACH

There are three principles that must form the bedrock of formulating a new compact between the Delhi Government and GOI, marrying the everyday interests of the denizens of Delhi with its status as the national capital. First, as was recommended by the Sitaramayya Committee set up by the Constituent Assembly to study this subject, Delhi must have a responsible government. This necessarily entails a government that is constitutionally equipped to serve the needs of its people. Second, for such government to be responsible to its people, the principle of subsidiarity must apply equally to Delhi as it does to all other States. This implies that the municipal corporations and other local bodies in Delhi, with enumerated exceptions, must be answerable first and foremost to the Delhi Government and not the GOI. Third, a circumscribed exception to the aforesaid principles must be introduced owing to Delhi's status as the national capital. The overriding power of the GOI which is currently all-pervasive must be subject to a direct or national interest qualification, i.e. in those subjects where the State Government is competent to legislate, it must have primacy to do so subject to a narrow exception that allows GOI to step in when its own or the national interest is at stake. This can illustratively happen in case any actions of the Delhi Government affect foreign embassies in Delhi or when the Delhi Government wants to take action against Central Government employees.

IMPLEMENTATION

Three pragmatic changes to the present legislative framework are necessary to give effect to the aforesaid principles. First, Article 239AA(3)(c) must be amended to give the Delhi legislature primacy in all matters where it has legislative competence. This will ensure that as a matter of course GOI cannot override decisions of the Delhi Government. Second, the Lieutenant Governor must be bound by the aid and advice of the Council of Ministers of the Delhi Government as is the case with the Governor in other States. Only in the exceptional situation when the Lieutenant Governor feels that his action would fall within the remit of the circumscribed exceptions stated above, should the matter be referred to the President. Relevant amendments to Article 239AA and the Government of National Capital Territory of Delhi Act, 1991 must be made for this purpose. Finally, attendant changes need to be made to all relevant statutes, to make municipal bodies and sub-state entities answerable to the Delhi Government. A failure to do so would make the Delhi Government dependent on the benefaction of the GOI, an anomaly in India's otherwise representative democratic setup. These changes will ensure that Delhi's status as a capital is adequately preserved in a manner analogous to major capitals in federal nations of the world, without damaging India's essentially federal character.

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INVESTIGATING TERROR CASES

THE CONFLICT

One of the most compelling arguments against the decentralisation of power in the last decade has been the growing threat of terrorism. Federal countries around the world have concentrated powers of both investigation and information-gathering in central agencies to deal with threats to national security. These measures however have been criticised as violating the principles of federalism.

In India, while law and order is traditionally the domain of the State, laws relating to the prevention, investigation and prosecution of acts of terror have been held to fall within the Concurrent List or under the Union List, particularly as justification for the establishment of the National Investigation Agency (NIA). The NIA was set up in 2008 as an immediate response to the terror attacks in Mumbai, with the powers of investigation in such cases concentrated in a central agency under the direct control of the Union Ministry of Home Affairs.

The NIA, unlike the CBI, does not require a State's consent to initiate investigation in relation to crimes listed in the Schedule of the NIA Act. The functioning of the NIA has been subject to extensive debate for violating State autonomy. In addition, issues of coordination and intelligence sharing have also been raised with respect to the functioning of the NIA vis-à-vis the State Police. Thus, even though the constitutional validity of the NIA has been upheld by the Bombay High Court in 2014, federal tensions continue to exist.

PROPOSED APPROACH

There is at present no clear basis in the Seventh Schedule for investigation of cases related to terrorism or national security, often forcing the Courts to post facto justify such legislation on unconvincing grounds. On the other hand, the need for a centralised agency to combat terrorism is also clear, given the threat it poses to the country as a whole. Thus, the most important change required is the express recognition of 'investigation of offences that threaten the unity or integrity of the nation' as a separate entry in the Concurrent List. This will resolve any future potential constitutional challenges to such legislation and pave the way for clear legislative demarcation of the powers of the States and the Centre. In addition, the NIA Act should be revisited to introduce certain procedural changes aimed at reducing the tension on this front between the Centre and the States.

IMPLEMENTATION

The practice in this respect has been gradually changing to recognise and acknowledge States' jurisdiction. That said, the introduction of certain changes may go a long way in effecting a comprehensive reduction in Centre-State tensions with respect to prosecuting terror cases. These include:

- Introduction of a new entry, 'investigation of offences that threaten the unity or integrity of the nation' in the Concurrent List to provide firm constitutional footing to central investigating agencies.
- Amendments to the NIA Act to balance Centre-State relations such as:
  - ❖ Section 6(3) of the NIA Act, which allows the Central Government to decide whether an offence falls within the NIA's purview, is widely worded and allows for taking into account 'other relevant factors'. In addition, Section 6(5) grants overriding powers to the Central Government to initiate investigation. There is no guidance currently on what such 'other relevant factors' may be. The Centre should spell out the specific criteria that would be taken into account while deciding whether an offence will be investigated by the NIA. Examples of such criteria could include involvement of inter-state or international elements, existence of a direct threat to national security, the potential involvement of the accused in other Scheduled Offences, etc. In addition, any order under Section 6(3) or Section 6(5) should be accompanied by reasons in writing.
  - ❖ It may also be considered to allow the State Government, if it so wishes, to bypass the involvement of the Central Government as laid down in Section 6 and approach the NIA directly to take over an investigation in certain cases, particularly where there is urgency and the prima facie jurisdiction of the NIA is established with respect to the offence being a Scheduled Offence.

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DEVELOPING BACKWARD AREAS

THE CONFLICT

One of the curious features of the existing regional disparity in India is the presence of backward areas within relatively prosperous States. This is because differences in demography and administration thwart the growth and development in some parts of a State from percolating into others. To address this, governments have either resorted to the provisions under Part XXI of the Constitution ('Temporary, Transition and Special Provisions') or availed of the financial assistance provided by the Centre under the Backward Regions Grant Fund Programme (BRGF).

Part XXI of the Constitution contains special provisions that endeavour to address the backwardness of regions in specific States, which had been historically disadvantaged (e.g. Vidarbha and Marathwada regions in Maharashtra, Saurashtra and Kutch in Gujarat, tribal areas under the Sixth Schedule and other such regions). Some of the measures specified include (1) setting-up of separate development boards; (2) reservations in educational institutions and public offices for persons residing in backward areas; and (3) allocation of funds for the purpose of development. Apart from historical legacy, there is no principled reason for limiting such measures to these States alone.

Unlike Part XXI, the BRGF had pan-India coverage. It sought to reduce regional disparity through direct intervention by the Centre. Under this Programme, central funding was provided to nearly 250 districts in 27 States. Under the 2015-16 Union Budget, the BRGF was discontinued and subsumed into the total expenditure of States. Hence, State Governments now have the primary responsibility of identifying backward areas and allocating funds for reform in these areas. However, evidence so far from the administration of backward areas has shown that State Governments have been unable to ascertain the criteria for backwardness with sufficient clarity. Further, political factors have meant that they have also been slow to independently chalk out the extent and form of development required in such areas. Focusing excessively on the State is a questionable method to reduce regional disparities.

PROPOSED APPROACH

Due to the absence of mandatory participation from the third tier in the present design, there exist substantial gaps in the present approach to counter backwardness. Prior to its termination, the BRGF mandated the participation of all three tiers. It was aimed at (1) ensuring the convergence of Central and State schemes; (2) pooling resources of both tiers for better growth outcomes; and (3) bridging critical gaps in the infrastructure at the local level. However due to the discontinuation of the BRGF, there now exists no mechanism for involving the third tier in the effort to remove regional disparities. Such participation is critical for ground-up implementation of reform in backward areas. At the same time, special provisions under Part XXI have limited scope and are not sufficiently detailed to allow for inclusion of the third tier in the development process.

To resolve this, a provision may be added under Part XXI of the Constitution by means of a constitutional amendment that lays down guidelines and systematises the process of development for any backward area in any State. Through its inclusion in Part XXI, this provision will support (1) integration of the provisions under Part XXI that currently operate in varying forms in a limited number of States; and (2) the expansion of the remit of Part XXI to include backward areas and regions in the rest of the States, which are currently not covered under Part XXI.

IMPLEMENTATION

The new formulation under Part XXI should allow for the following:

- Enumerating specific determinants of backwardness, which take into account the most basic benchmarks of economic progress.
- Clarifying the role and responsibility of State Governments in —
  - ❖ Conducting an independent periodic study for the identification of backward areas.
  - ❖ Preparing a plan for development in consultation with rural and urban local bodies under Part IX and Part IXA of the Constitution.
  - ❖ Specifying a procedure for devolution of funds to local bodies in backward regions that is based on the periodic study and the plan for development. This should be in the form of performance based tied grants, which ensures targeted spending and incentivisation.

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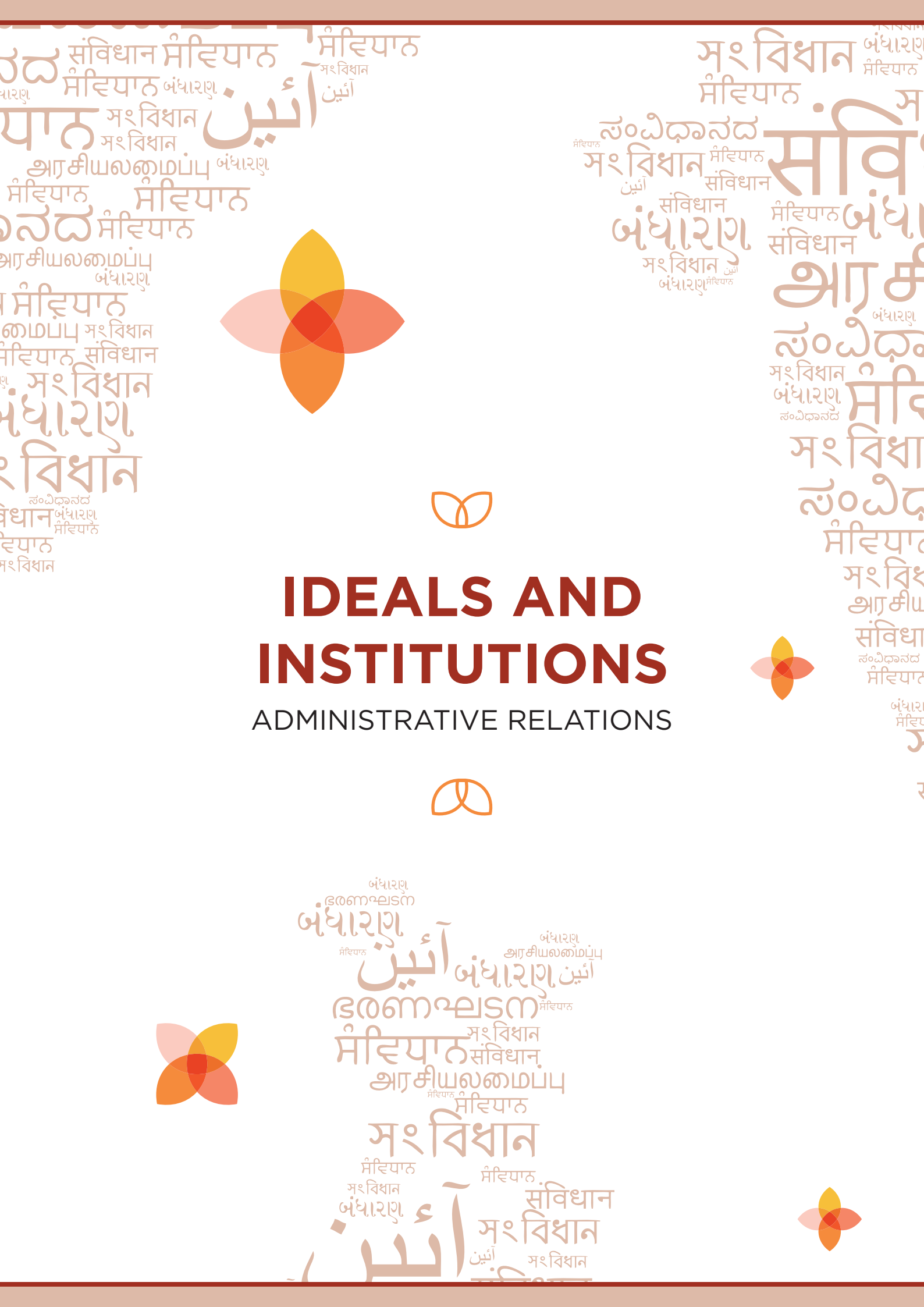
IDEALS AND INSTITUTIONS

ADMINISTRATIVE RELATIONS



Federalism traditionally describes the formal relationship and division of power between the Centre and States or provinces. However, governance in a federal system involves a degree of interdependence and involvement beyond the formal relationships between a State and the Centre. It involves the interaction of elected officials at all levels of government, as well as the bureaucracy, political parties, judiciary and the private sector. Thus, there is no clean division of power and responsibilities in a federal system. (Arora et al, 2007) This is particularly relevant in systems of integrated federalism, such as in India, where States implement numerous central laws, and share institutions such as the Indian Administrative Service. This inevitably increases the level of interdependence, as well as conflict, with units regularly raising challenges about the roles and responsibilities of other units.

The notion of cooperative federalism is a normative vision of what interaction in a federal system should look like. Cooperative federalism asks that the interaction among federal units be geared towards achievement of common goals. For this, it is important to first understand federal realities by moving the inquiry beyond constitutionally established roles and responsibilities, to look at the array of sub-constitutional and informal modes of interaction that have been at play in India, with varying degrees of success.

Successful federal interactions depend on a number of different factors, such as the relative size and number of the federal units, discrepancies in wealth, population and political influence, the availability of resources and capacity, and the design of the instruments of government. It is this last factor that forms the subject of study in this section.

The first set of instruments may be described as structural, comprising formally defined roles and relationships, including constitutionally mandated institutions such as governors and intergovernmental bodies. While intergovernmental bodies have been mandated to facilitate coordination and relationships between the Centre and the States, the Governor as a constitutional post is an example of the formal relationship between the Centre and States which attempts to integrate and build links between the Centre and the State Governments.

In contrast, programmatic instruments such as the NREGS involve the application of resources to solve specific social or economic problems by the federal unit with the assistance of the Centre. While the contours of each programme may look different — from purely financial interdependencies to deeper collaboration between the two levels of government — they entail a significant degree of coordination and recognition of the need to pool resources and group processes for the achievement of the goal.

Finally, the third type of instruments are behavioural in nature, which establish relative degrees of autonomy and accountability. The behavioural approach is useful in studying political or administrative interactions such as those between High Courts and the Supreme Court in relation to administration of High Courts, specifically appointment, transfer and disciplinary actions related to High Court judges.

Interactions, if channelled appropriately, can assist in developing the full potential of a cooperative federal system. However, it is also important to keep in mind that inappropriate and excessive use of these instruments can lead to creation of deadlocks and lack of accountability and transparency. Interactions, both formal and informal, are the bedrock of a functional federal system which can adapt and flourish in a constantly changing global environment. Often, government instruments in developing federal countries are designed without conscious incorporation of the incentives and resources required for successful cooperative interactions. This section looks at a few of these federal instruments in India, studies the way they interact, and suggests ways in which these can be made more effective.

STRENGTHENING INTER-STATE BODIES

THE CONFLICT

With the determination to usher in an era of cooperative federalism, intergovernmental organisations forming platforms for collaboration between States have recently evoked considerable public interest. This is because the lack of strong and well-functioning intergovernmental structures is particularly damaging in a diverse country like India, where developed States co-exist with less developed ones.

The constitutional duty to implement Centre-State cooperation lies with the Inter State Council (ISC) under Article 263, which consists of the Prime Minister, Chief Ministers of States and six other Union Ministers. Other intergovernmental bodies operating with varying degrees of formality include the Zonal Councils, Chief Ministers' and Ministers' Conferences. The ISC has had little impact on Centre-State relations in all its years of existence, and it has not been reconstituted since 2014.

While the ISC has received relatively little attention in the past few years, a move touted by the Central Government as a boost to cooperative federalism was the abolition of the Planning Commission (PC) and the establishment of the NITI Aayog earlier this year. The membership of the Niti Aayog consists entirely of Union Ministers and of experts appointed by the Centre. However, it also sets up a Governing Council that includes the Chief Ministers of all States and Lieutenant Governors of all Union Territories. The precise role of the Governing Council was not described in the Cabinet Resolution setting up the NITI Aayog. As a result there is a seeming lack of clarity about its role, exacerbated by the fact that its goals are similar to those of the ISC. Additionally, NITI Aayog has been authorised to set up regional councils — this is similar to the role currently played by the Zonal Councils.

In this context, there are various concerns about Indian intergovernmental bodies, namely:
(a) whether the functions of the Governing Council of the NITI Aayog and the ISC overlap; and
(b) what measures can be taken to eradicate the institutional weaknesses of intergovernmental bodies, whether it be the ISC or the Governing Council of the NITI Aayog.

PROPOSED APPROACH

The coordination mechanism of a federal nation should avoid unnecessary bifurcation of the apex intergovernmental body. Such artificial separation imposes undue burden on the exchequer, results in proliferation of councils that lack an integrated and authoritative approach, and makes intergovernmental consultation processes cumbersome.

Whilst intergovernmental organisations can be set up either constitutionally or as a matter of convention, in a country with numerous and diverse federal units, it is necessary to establish formal bodies for cooperation which are participative, transparent and accountable. Experience with the PC and the ISC demonstrates that non-formal bodies could either wield excessive powers as they are not defined or limited (as in the case of PC) or go into a dormant mode (like ISC).

Thus, effectiveness of intergovernmental organisations requires both (a) formality and accountability granted by constitutional or statutory status, and (b) established procedures for consideration and implementation of its recommendations.

IMPLEMENTATION

First, in order to prevent overlapping functions and consequent dormancy of earlier institutions, it is crucial to have a policy document demarcating the role of the existing intergovernmental organisations.

Second, the position of the ISC should be strengthened as it is the only constitutionally mandated platform for inter-state collaboration. In order to ensure that the ISC functions autonomously and for its recommendations to be given due consideration, it is necessary that it is vested with sufficient independent legal standing. In order to provide statutory basis to the ISC, Article 263, which currently mandates that the ISC be established by Presidential Order, will have to be amended.

Third, though a recommendatory role is envisaged for ISC and NITI Aayog, measures ought to be taken to impose a positive duty on the Centre as well as the States to consider and implement its decisions. As with the recommendations of the Finance Commission, the concerned Governments may be obliged to present a memorandum or action taken report explaining steps taken with respect to the recommendations.

Fourth, the autonomy of intergovernmental organisation should be enhanced through steps such as introducing a shared bureaucracy, with staff from both the Centre and the States appointed to the relevant Secretariat.

Finally, it is crucial to understand that the litmus test does not lie in the nomenclature of the organisation or policy documents. On the contrary, meaningful implementation of cooperative federalism is entirely contingent on whether there is enhanced seriousness on the part of the Centre and the States in supporting the NITI Aayog and ISC.

In a country with numerous and diverse federal units, it is necessary to establish formal bodies for cooperation which are participative, transparent and accountable.

ENSURING GOVERNORS' INDEPENDENCE

THE CONFLICT

The Governor, being the constitutional head of the State appointed by the President, was originally envisioned as an apolitical figure, devoted to the service and well-being of the people of the State and acting as a conduit between the Centre and the State. The role of the Governor in the Indian political system, however, has been mired in controversy since the 1960s, once different political parties started coming into power at the Centre and the States.

The Governor serves a five-year term. However, his tenure is subject to the pleasure of the President. In practice, Governors appointed by previous Central Governments are removed from office for not being 'in sync' with the political ideology of the current Central Government before their terms end. Numerous such premature removals, with no assignment of cause or opportunity to be heard, have shattered the security of the tenure of the office and lowered the prestige of the institution, making it impossible for Governors to function impartially and remain apolitical. This has struck at the heart of the federal character of our Constitution.

The root cause for this breach lies in the manner in which the doctrine of pleasure, as applicable to the removal process of Governors, is construed. The seminal judicial clarification of the Supreme Court in *BP Singhal* v *Union of India* (2010) which lays down that 'not being in sync with the political ideology of the current Central Government or losing their confidence are not valid causes for removal of the Governor under Article 156(1) of the Constitution of India' has not deterred the reigning Central Governments to do exactly that, albeit indirectly. The Central Governments' stance has been assisted by the interpretation that the mere existence of a valid reason for removal is sufficient, with no requirement of notice or assignment of said reason.

To infuse the constitutional importance of the Governor envisaged by the makers of the Constitution into practice, key constitutional amendments that introduce limitations on the doctrine of pleasure are necessary.

PROPOSED APPROACH

This interpretation of the doctrine of pleasure is resonant of the doctrine applicable in a feudal setup, where the power of removal of servants of the Crown was absolute and unfettered. This amplifies the view that the Governor is a mere titular head and an agent of the Central Government, which is completely contrary to the independence of the Governor's role, as envisaged in the Constitution. Removal of civil servants holding office during the pleasure of the President or Governor under Article 311(2) of the Constitution of India is governed by similar limitations, and thus there appears to be no reason for the tenure of the Governor to be subject to the unfettered discretion of the President. Therefore, to infuse the constitutional importance of the Governor envisaged by the makers of the Constitution into practice, certain key constitutional amendments that introduce limitations on the doctrine of pleasure are necessary.

IMPLEMENTATION

Article 156 requires amendment to insert limitations on the doctrine of pleasure in relation to:

- it being invoked on enumerated grounds, for instance, on violation of the Constitution by a Governor (as is for the President, for acts of withholding assent to a money bill passed by the State Legislature; not acting as per the aid and advice of the Council of Ministers in the required instances; acting against public interest etc.) or due to demonstrable misbehaviour or incapacity (as is for High Court and Supreme Court judges) and formal assignment of the said cause for removal to the Governor; and
- providing the Governor a right to be heard.

This would protect the Governor's tenure from unjustified removals. An attempt to restore the functionality of the office of the Governor through a sanctified constitutional amendment will empower the Governor to fulfil his constitutional role without the need to pander to the Central Government's ideology and without the threat of removal.

REVIVING THE AUTONOMY OF HIGH COURTS

THE CONFLICT

In public perception today, High Courts are widely viewed as subservient to the Supreme Court of India. Recent orders of the Supreme Court pertaining to the Jayalalithaa appeal and to the filling up of subordinate judiciary posts in Karnataka demonstrate a growing trend of the Supreme Court directing High Courts on their administrative functioning, lending credence to such a view. In the Constitution however, High Courts are seen as masters of their own territories with complete administrative autonomy and legal finality over many categories of disputes. Over time, practice has strayed far from the constitutional text. The rate of acceptance of appeals from High Court orders has significantly increased. Orders of the Supreme Court directing the High Courts to perform their administrative tasks in a particular manner are routine. High Court judges are widely known to lobby for Supreme Court elevations with the Supreme Court collegium. Not only have these developments affected the public image of the High Courts, but they have also increased the workload and consequently the backlog of the Supreme Court considerably.

PROPOSED APPROACH

Much of the overreach by the Supreme Court has been attributed to the perceived diminishing quality of High Courts. Even if this is true, a revival of quality cannot be led by judges of the Supreme Court who are far removed from local factors that govern High Court appointments and functioning. On the contrary, by making High Courts both autonomous and judicially accountable, their constitutional status and quality can be set on a path of restoration. This involves two categories of reform — legislative changes to underline the high status of High Courts and behavioural changes that make the High Courts and not the Supreme Court the key agents for its own reform. Neither will automatically reduce backlog in the Supreme Court nor improve the quality of the High Courts. But both will restore the public perception of High Courts, key to attracting talent, securing public confidence and unlocking several contingent judicial reform proposals.

IMPLEMENTATION

Four legislative changes are necessary for this purpose: First, the newly constituted National Judicial Appointments Commission must make regulations providing for the Chief Justice of the High Court to be a mandatory invitee to deliberations when selections to that High Court are made. A healthy convention of acting on the views of the Chief Justice should consequently develop. Second, for transfer of High Court judges, the consent of both the Chief Justice of the transferor and transferee High Courts should be mandatorily sought. These will ensure that the Supreme Court judges do not have the last word on High Court appointees. Third, the High Court Judges (Salary and Conditions of Service) Act, 1954 should be further amended to provide salaries and pensions of High Court judges and the Chief Justice at par with Supreme Court judges. This will formally recognise the equivalence of judicial functions of the High Courts and the Supreme Court. Fourth, the lapsed Constitution (114th Amendment) Bill increasing the retirement age of High Court judges to 65, thereby equalising it with the Supreme Court retirement age, should be reintroduced. This is likely to diminish, though not neutralise, the spectre of High Court judges lobbying for Supreme Court judgeships to extend their judicial tenures. Finally, accountability of the High Courts must be stringently enforced by the Supreme Court scrupulously exercising its appellate powers, not using such powers as a guise to interfere in their administrative functioning. Ultimately, it is mutual respect rather than elder brotherliness on the part of the Supreme Court that is key to High Courts commanding wide public confidence.

Quality and autonomy in High Courts cannot be led by judges of the Supreme Court who are far removed from local factors.

REDUCING SUB-NATIONAL VARIATIONS IN THE NREGS

THE CONFLICT

Touted as the largest employment generation programme in human history, the National Rural Employment Guarantee Scheme (NREGS) was ambitiously launched in 2006 in 200 districts of the country. The Scheme aims to ensure livelihood security in rural areas by providing at least 100 days of wage employment in a financial year.

The NREGS is a centrally sponsored scheme ultimately implemented by State Governments. Funds are disbursed by the Central Government based on labour budgets prepared by the State Governments. The utilisation of these funds, in turn, takes place at the local level where Gram Panchayats and Gram Sabhas are responsible for identification of the projects to be undertaken in the areas under them. The Gram Sabhas also conduct regular social audits of all the projects under the NREGS.

To its credit, the National Rural Employment Guarantee Act, 2005 (under which the Schemes are notified) provides ample scope for a bottom-up approach giving enough leeway to local administration to adapt the Scheme to their needs and undertake works accordingly. In theory, the implementation of the NREGS serves as a compelling example of how cooperative federalism can take shape in practice as it involves institutions at the Central, State as well as local government levels.

However, like other schemes financed by the Centre but implemented by the States, the performance of the NREGS is characterised by sub-national variations. Many of these problems arise from the fact that the implementation of the Act was not accompanied by simultaneous recruitment of trained personnel at the local level. Paucity of manpower has led to two major issues — under-utilisation of labour budgets and lack of uniformity in the conduct of social audits. The performance of Gram Panchayats across States has also varied. While Kerala and Madhya Pradesh have had active involvement of the Panchayats, in Jharkhand, for a few years, decisions on allocation of work were being made by the Governor.

Reducing sub-national variations in the NREGS requires two key interventions — strengthening of social audits and capacity building of administrators.

PROPOSED APPROACH

Reducing sub-national variations requires two key interventions — strengthening of social audits and capacity building of administrators. Well-conducted social audits contribute to accurate labour budgets since the monitoring exercise reveals the pattern of utilisation of the money allocated to the State. Social audits, as a monitoring mechanism hinge on the appointment of skilled persons to form part of the Social Audit Committee.

The implementation of the NREGS is also incumbent on capacity-building in local areas to deal with complex administrative and technical tasks. Capacity building should adopt a two-fold approach — adequately train existing field staff as well as deploy trained and qualified personnel where shortage exists.

IMPLEMENTATION

The 2015 budget gave a significant boost to State autonomy with States being granted a greater say in the manner of implementation of various schemes such as the NREGS. The NREGS is now a State scheme, instead of a central scheme, and can be dovetailed into the States' own programmes for rural development. States like Madhya Pradesh have already begun taking this approach. In this light, labour budgets should be prepared keeping in view possible amalgamations with other schemes.

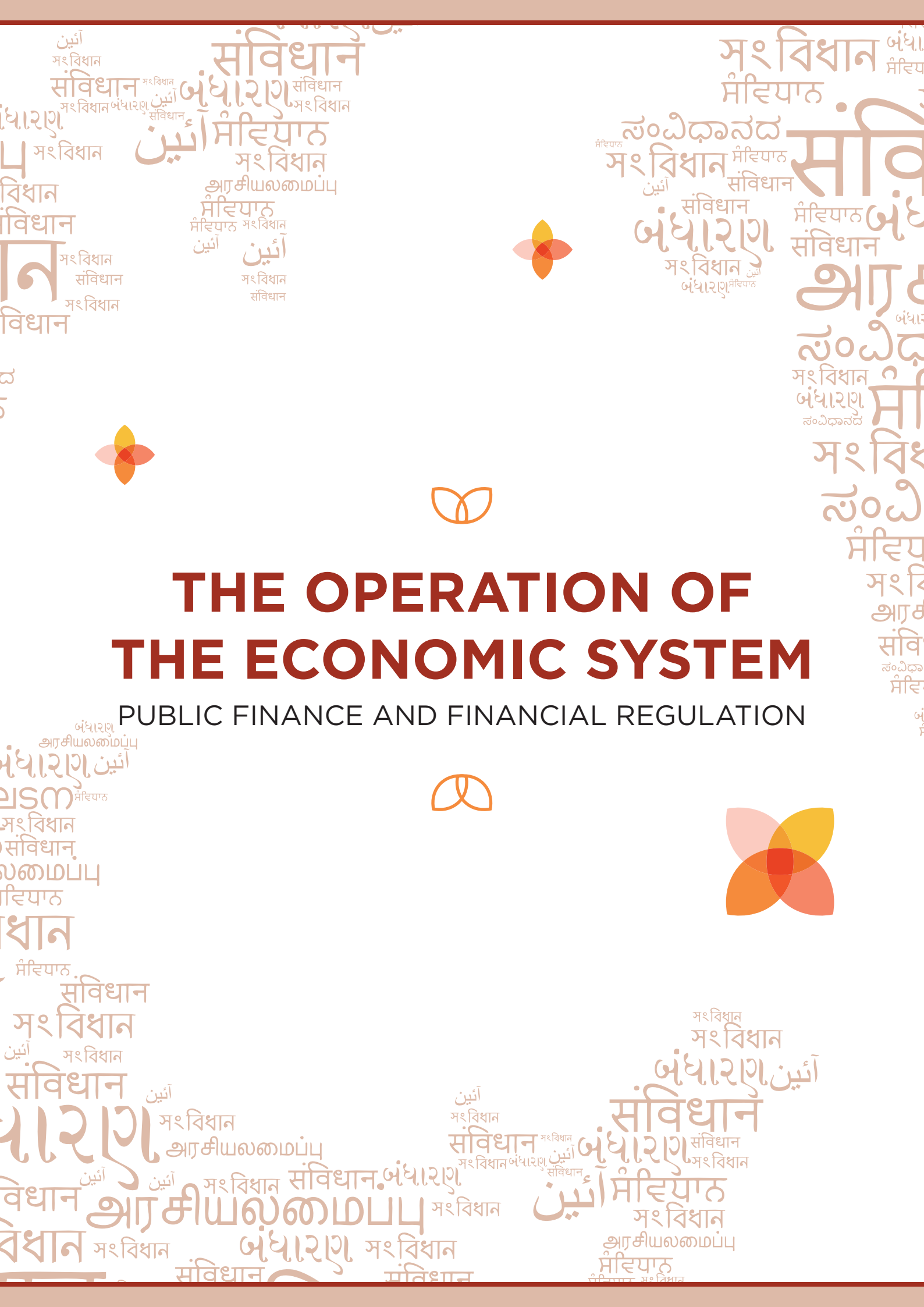
In light of enhanced financial and decision-making autonomy, NREGS can greatly benefit from concentrating on capacity-building activities, particularly at the level of local governments. Capacity-building should focus on improving the ability of elected representatives to conduct social audits and to measure the quality and volume of work. In this regard, cooperation from the National and State Institutes of Rural Development (NIRD and SIRDs) can be sought to provide training, technical knowledge and administrative skills so as to fruitfully train personnel to be part of local decision-making under the NREGS.

Social audits may be strengthened with further normative guidelines. Currently, the only guideline is that Gram Sabhas have to conduct a social audit every six months. Social audits are a critical monitoring exercise and can be conducted at any time during or after the implementation of the NREGS. To enforce the conduct of social audits, a certain minimum number of meetings of the Gram Sabha can be made mandatory under the NREGS.

The provisions of the NREGS as well as the flow of funds architecture currently seem to be facilitative of the aims with which the ambitious legislation was enacted. If they can be ably supplemented with capacity-building of the Panchayati Raj Institutions, the right to work would achieve true realisation.

THE OPERATION OF THE ECONOMIC SYSTEM

PUBLIC FINANCE AND FINANCIAL REGULATION



In February 2015, the Fourteenth Finance Commission made a remarkable recommendation to the Government of India: an unprecedented increase in the share of the divisible pool of tax revenues transferred from the Centre to the States, from 32% to 42%. The Central Government accepted this recommendation in its budget for 2015-16, and, in doing so, launched a new era in Centre-State fiscal relations in India.

This important shift was framed in the context of cooperative federalism, a phrase that was mentioned 25 times in the Report of the Fourteenth Finance Commission — there was even an entire chapter devoted to moving towards this most desirable of principles. Of course, steps in this direction had already been taken the previous year with the dismantling of the Planning Commission that had been, amongst other things, responsible for allocating central transfers to the States to be spent on meeting various development needs. Its replacement, NITI Aayog, is committed to 'cooperative federalism' and, in particular, ending the 'one-way flow of policy' from the Centre to the States.

This change in direction has been celebrated by a number of constituencies, including, of course, the States themselves, who have long complained that the Centre has been effectively dictating their developmental priorities. Allowing State Governments to chart their own paths is both fair and likely to result in more efficient outcomes. However, different States are at different stages of development: a reduction in central development spending could arguably lead to widening gaps in the standards of living across the States. Ensuring horizontal equity across States is a critical aspect of cooperative federalism, as well as perhaps the best argument for persisting with Central Government programmes relating to core aspects of social welfare. State finances also vary considerably and some of the weaker States have protested that the 2015 budget diluted the proposals of the Fourteenth Finance Commission to their detriment. Even as States received a greater share of tax revenues, the taxes themselves were reduced, sometimes replaced by surcharges and cesses to be collected by the Central Government. Central spending support for State plans also declined. The implications of this for States, and more critically for the third tier, are yet to be fully mapped out. Wrangling over public finances in the States is likely to be a test of Centre-State relations that will surface around every Union budget over the next few years.

The greatest test of cooperative federalism, of course, has been the implementation of the Goods and Services Tax (GST). States have held up this legislation in Parliament because of concerns that they are not being adequately compensated for losses they may suffer as a result of the tax. Widely regarded by most economists to be an integral part of an efficient common market, the GST proposal has languished for many years because of a failure of effective Centre-State and inter-state cooperation. Perhaps the new paradigm of federalism can help the country make substantial movements towards this much-needed reform.

Another area of conflict is over the many loopholes that exist in financial sector regulation, where similar types of financial institutions, such as microfinance lenders and cooperative banks, are regulated differently by Central and State regulators, as well as across different States. A key lesson of the 2008 global financial crisis is that in order to effectively manage systemic stability, such instances of regulatory arbitrage must be eliminated. If India's Central and State Governments are to accomplish this within the existing regulatory architecture, there would have to be an unprecedented level of coordination between the different regulators. Alternatively, the regulatory regime must be overhauled to close the loopholes and delegate powers to a single central regulator. In this instance, the spirit of cooperative federalism may be better served if State Governments take a step back from aspects of financial sector regulation.

Against this backdrop, this section looks at some of the emerging issues of fiscal federalism and financial regulation, highlights aspects that may stand in the way of cooperative federalism, and makes suggestions on the way forward.

DEVOLVING FUNDS TO LOCAL BODIES

THE CONFLICT

The 73rd and 74th Constitutional Amendments carved out the third tier under the federal framework of India, signalling a watershed in the history of Indian democracy. These amendments sought to boost decentralisation through the empowerment of urban and rural local bodies under the federal principle of subsidiarity. However nearly two and a half decades after the passage of these amendments, effective local governance continues to elude us. As pointed out by consecutive reports of the Finance Commission, the excessive and unwarranted dependence of institutions of local governance on State Governments is the chief cause of their failure.

Under Entry 5 of the State List, State Governments are vested with the primary responsibility of empowering local bodies in becoming self-reliant. In discharging this obligation, States have enacted legislations that provide for a comprehensive framework for the devolution of funds to such bodies through tax share and grants-in-aid, the percentages of which are determined by State Finance Commissions. While these interventions have led to the creation of these local bodies, lack of funds and political manoeuvrings have undermined their independence and efficiency. With the growing emphasis on effective cooperative federalism, local bodies need to be made truly autonomous in the discharge of their responsibilities, to make them function as real agents of social and economic change.

PROPOSED APPROACH

The Fourteenth Finance Commission has pointed out that the issues plaguing local bodies can be resolved through, inter alia, improving the role of State Finance Commissions and increasing the share of taxes collected by such bodies. Although the recommendations of the Finance Commission point out several issues of concern, persistent problems on the ground block the effective operationalisation of these local institutions.

Experts suggest that politicisation of local bodies is the main factor that contributes to their lack of enthusiasm in functioning as independent institutions of self-governance. Local body elections invite the scourge of vote bank politics, and incentivise non-collection of taxes and unwillingness to engage in affirmative action. Interference of State Governments through their officers appointed as secretaries and commissioners in the area also adds to the powerlessness of these institutions. Further, the funds that are devolved to local bodies in the form of grants are usually conditional, or tied to specific purposes, thereby reducing independence in spending. Given these factors, institutions of local governance in a majority of States continue to remain toothless in determining their mandate. There is however, scope for improving local governance through legislative and policy measures that infuse independence and accountability into these institutions.

IMPLEMENTATION

The following legislative and policy measures incorporated as amendments to the State Panchayati Raj and the Municipal Corporation Acts can be instrumental in realising the goal for an effective third tier.

- Stipulate the mandatory collection of local taxes, especially property tax that can serve as the principal source of independent revenue for local institutions.
- Heavily penalise omissions or actions by elected members on the local bodies that reflect involvement in vote bank politics.
- Reduce the functionality of non-elected members on the local bodies through restricted roles.
- Update the tax share of local bodies in light of fluctuations in the value of goods and services.
- Mandate a process for the devolution of funds from the Centre and the State through specific criteria, methodology and timelines.
- Necessitate State follow-up action on the reports of the State Finance Commissions under pre-determined time-lines.
- Provision for incentives and disincentives for local bodies in the discharge of their functions in a given local area, through fiscal benefits that provide necessary resources.

With the growing emphasis on effective cooperative federalism, local bodies need to be made truly autonomous in the discharge of their responsibilities

STRENGTHENING THE GST COUNCIL

THE CONFLICT

The Goods and Services Tax (GST) has been envisaged as a uniform indirect tax on goods and services in India, cutting through the current maze of State and Central Taxes. The GST seeks to create a unified mechanism for the collection of indirect taxes that benefits tax-payers and helps create a true national market for goods and services. Since this involves the harmonisation of a multitude of local taxes, impacting tax revenues of States, there are significant disagreements over the shape and implementation of the GST between the States and between Centre and States.

The Constitution (122nd Amendment) Bill, 2014 (2014 Amendment) which creates the constitutional framework for the GST also creates a Goods and Services Tax Council (Council) to resolve issues of implementation. The Council comprises the Union Finance Minister as Chairperson, and the Union Minister of State for Finance or Revenue, and all Finance Ministers from the respective State Governments.

Three main problems are evident in the structure of the Council as provided for in the 2014 Amendment. First, there is scope for confusion over whether the 'recommendations' of the Council are binding, as some clauses seem to suggest that they will be binding while others indicate the opposite. Second, recommendations of the Council are made on the basis of a three-fourths majority of the members of the Council. However, not all members of the Council have an equal vote in the Council. The votes are weighted with the Central Government's vote having the weight of one-third of the total votes cast and all the States together having two-thirds of the total votes. With the requirement for majority being three-fourths of the votes cast, this effectively gives the Centre a veto over all 'recommendations' of the Council. Since the Council plays an important role in resolving differences between Centre and States as well, an unbalanced voting mechanism which tilts heavily towards the Centre is unlikely to inspire sustained confidence of the States. Further, no dispute resolution mechanism from decisions of the Council is provided for in the 2014 Amendment. This creates uncertainty as to how the recommendations of the Council will be enforced.

Such a mechanism which allows the Centre to determine and direct the tax policies of a State through a binding 'recommendation' of the Council is unlikely to pass the 'basic structure' test in that it could amount to a violation of the Constitution's basic feature of federalism.

PROPOSED APPROACH

The smooth operation of a GST framework requires balancing the need to take decisions by consensus, as far as possible, with the need to resolve deadlock. The decisions of the Council also need to be enforced and implemented in a timely and effective fashion, and to this end, an effective dispute resolution mechanism is needed.

IMPLEMENTATION

Since the disputes concerning the recommendations of the Council are likely to be Centre-State or inter-state disputes, it may therefore be appropriate to have such disputes resolved in accordance with Article 131 of the Constitution, by the Supreme Court of India. It is therefore proposed that the 2014 Amendment Bill be modified to state that:

- The Council will take decisions that are binding on the Centre and States.
- Where consensus is not possible within the Council, a decision to be taken by three-fourths majority with each State and the Centre getting one, non-weighted vote.
- Where a State or the Centre is aggrieved by the recommendation of the Council, it may challenge the same before the Supreme Court of India under Article 131 of the Constitution.

The Council is a key institution in meeting the goals of the GST — creating a national market for goods and services, promoting inter-state trade and commerce, and creating a simpler indirect tax system for businesses. A Council where States are part of the process on an equal footing with the Centre, along with a clear process for dispute resolution, is essential to ensure that the uniform mechanism to levy and collect GST works smoothly and in a cooperative manner.

Since the GST Council plays an important role in resolving differences between Centre and States, an unbalanced voting mechanism which tilts heavily towards the Centre is unlikely to inspire sustained confidence of the States.

CONCEPTUALISING E-COMMERCE LAWS

THE CONFLICT

E-commerce, defined as the sale and purchase of goods and services over an electronic platform, has seen massive growth in just the last five years. In India, it has gone from transactions worth $3.4 billion in 2010 to an estimated $22 billion in 2015. With increasing access to the internet through smartphones and broadband connections, the e-commerce sector is likely to grow even faster in the next few years.

Rapid growth in a new sector inevitably results in unprecedented regulatory challenges. In the case of e-commerce, the question is whether States or the Centre is best placed to tax or set standards for e-commerce. While States should be free to legislate on local matters under the State List and the Concurrent List, where such diverse local legislation has a negative impact on the ability of the Centre to regulate inter-state trade and commerce under Entry 42 of the Union List, the Centre has been empowered to legislate on such matters. This is especially true of businesses which are carried on online.

Unlike 'brick and mortar' businesses, the market for an e-commerce service is not restricted by physical boundaries and limitations, and is likely to span multiple States. Individual States applying the norms and regulatory practices developed in the context of 'brick and mortar' businesses without suitable modification to e-commerce businesses has led to legal and regulatory confusion.

Two recent examples show the obstacles in the path of further growth in the sector:
1. The dispute between e-retailers such as Amazon and Flipkart, and the Karnataka State Government over whether they are dealers or simply 'marketplaces' in terms of their obligation to pay VAT; and
2. The 'banning' of online taxi service aggregators such as Uber, Ola and TaxiForSure with each State and Union Territory adopting a different and contradictory approach. For instance, while the State of West Bengal has treated these services as being within the purview of the Information Technology Act, 2000, the Government of Telangana has sought to bring them under the purview of the Motor Vehicles Act, 1988 through amendments.

The lack of uniformity in the approach towards e-commerce businesses will only increase costs of operation in a sector which has great potential for growth and job creation. The growth of e-commerce may be stifled if the regulatory and compliance costs on the businesses are increased due to conflicting and contradictory approaches of various State Governments to the matter.

PROPOSED APPROACH

To address the problem of conflicting approaches in State level regulation, creating a set of norms at the national level is necessary. Such norms will define the manner in which e-commerce transactions will be assessed for the purposes of regulation. Since e-commerce has a major impact on inter-state trade and commerce, and is more likely than not, an inter-state transaction, this necessitates law made by Parliament under Entry 42 of the Union List. Such a law will govern both goods and services offered directly by means of the internet, and also 'online-marketplaces' which connect buyers and sellers of goods and services, and clearly demarcate the difference between the two. It will thus re-calibrate the 19th and early 20th century laws currently governing 'sales' and 'contracts' to the realities of e-commerce transactions currently taking place.

IMPLEMENTATION

The proposed law will be a comprehensive code applicable to e-commerce transactions, updating existing norms to meet the changes in technology and also creating new legal definitions of terms such as 'online marketplace' and 'service', which have hitherto not been clearly defined in Indian law.

The proposed law should also make clear the legal liabilities and responsibilities of the buyer, seller and intermediary (such as an online marketplace) in an e-commerce transaction, which at the moment, is unclear and dependent on a case-by-case approach of the Courts. For instance, the proposed law will state that an online marketplace's liability should extend only to services that it offers, such details of price and product, and not for products that may be bought and sold on the marketplace. A comprehensive code of law will clarify to the States the approach to the legal aspects of e-commerce transactions and bring certainty to regulation in this nascent sector. Such a law should define concepts, lay down norms and fix liability for transactions that take place over the internet, setting to rest contradictory and confusing compliance issues in different States.

Following the broad norms laid down in the central legislation, State Governments shall remain free to levy taxes on e-commerce transactions, create regulatory mechanisms for e-commerce and implement specific laws pertaining to e-commerce. The norms set out in the central legislation will act as a uniform guide to all States in their regulatory and taxing functions.

Individual States applying the norms and regulatory practices developed in the context of 'brick and mortar' businesses without suitable modification to e-commerce businesses has led to legal and regulatory confusion.

SUPERVISING URBAN CO-OPERATIVE BANKS

THE CONFLICT

Although urban co-operative banks (UCBs) account for a small proportion of deposits and advances in the banking system, they contribute significantly towards financial inclusion. However, while UCBs were established to primarily increase community participation and credit access in underserved areas, over a period of time, their financial health has declined significantly. About 89 co-operative banks have failed in the four year period between 2009 and 2013, forcing the Deposit Insurance and Credit Guarantee Corporation (DICGC) to pay out huge amounts to depositors. In 2012-13, the DICGC paid as much as INR 160 crore to deposit holders of the 13 banks. This, however, covered only part of the losses. Failure of most UCBs is attributable to poor governance, raising questions about the effectiveness of the present regulatory regime to address the situation.

Although 'banking' falls under the legislative competence of the Parliament, regulation and liquidation of co-operative societies (other than multi-state co-operatives) is a State subject. UCBs are thus subject to State laws on co-operative societies for incorporation, management, liquidation, etc. and parts of the Banking Regulation Act, 1949 (BR Act) for banking related issues. Moreover, there are several examples of State laws on co-operatives that encroach on the area of banking regulation. The RBI sought to address the implementation issues created by this dual approach by entering into memoranda of understanding (MoUs) with State Governments to have a greater role in supervising and resolving UCBs and directing the State Governments to take necessary actions, including on issues relating to management.

However, implementation of such MoUs is subject to several operational constraints as the relevant implementing authorities are under the control and supervision of the State Governments. As indicated in the report of the Committee on Financial Sector Reforms in 2008, one of the key problems created by this dual approach is that neither the RBI not the State Governments bear "full responsibility for problems that might emerge". In relation to resolution of failed UCBs, Dr. D Subbarao, former Governor of the RBI, notes that because of the aforesaid dual control, delays are experienced in resolution of UCBs over several issues. RBI's most recent 'Financial Stability Report' also acknowledges the "need for improving the governance, capitalisation and resolution mechanism in cooperative banking".

PROPOSED APPROACH

The problem outlined above is directly linked to the constitutional allocation of powers between the Centre and the States and requires a close review of the arbitrage opportunities created by such allocation. It can be strongly argued that large and complex UCBs are analogous to other scheduled banks and thus there is no justification for subjecting them to a dual (and less effective) regime only because they are incorporated as 'co-operatives'. The Central Government should consider consulting the State Governments on introducing necessary amendments to the Seventh Schedule of the Constitution for carving out UCBs from the legislative competence of the States, to facilitate direct supervision by the RBI.

IMPLEMENTATION

The Central Government should consider initiating a national consultation on the recommendation made by the Financial Sector Legislative Reforms Commission that "…State Governments should accept the authority of Parliament…to legislate on matters relating to the regulation and supervision of co-operative societies carrying on financial services". It is counter-intuitive to let the Parliament's competence to legislate on a functional matter, i.e., 'banking' get curtailed by the State Governments' competence to legislate on the form of legal entity. However, it is also critical to incorporate the view of the States in this matter. The consultation may initially be focused on carving out large and complex UCBs (above a certain threshold of assets and/or deposits and those with systemic linkages to the economy).

In any case, in so far as insolvent or near insolvent UCBs are concerned, given that 'bankruptcy and insolvency' is listed in the Concurrent List of the Constitution, (a) all provisions in the BR Act that relate to insolvency resolution of banks in general (including provisions relating to liquidation) or (b) a central law such as the draft 'Indian Financial Code' that proposes to establish a 'Resolution Corporation' for insolvency resolution of all financial institutions, can also be applied to UCBs without disturbing the existing constitutional framework.

Failure of most UCBs is attributable to poor governance, raising questions about the effectiveness of the present regulatory regime to address the situation.

IMPROVING THE REGULATION OF CHIT-FUNDS

THE CONFLICT

Commercial chit-funds or rotating savings and credit associations (RoSCAs) first emerged in India in South Indian towns and cities and soon spread to other parts of the country. A typical chit fund works as follows: (a) subscribers to the fund make equal fixed contributions on a periodic basis, (b) the money thus collected (usually referred to as 'pot') is auctioned within the group at the end of a specified period, with the highest bidder taking the pot minus the amount that he bid for, and (c) the remaining amount is equally distributed among the subscribers after allowing the organiser to deduct his pre-determined fee. There could be several variations to this depending on the terms of a chit fund scheme. Chit-funds gained popularity on account of relatively higher returns (or a perception of such returns) for the subscribers in comparison to bank deposits and because they provide a source of funds for small businesses and rural communities, which have limited or no assets for raising finance. Soon after chit-funds became popular, several government appointed committees found that they are prone to unfair practices and scams, underscoring the importance of regulating them appropriately. However, such committees also recognised the important credit-intermediation function performed by chit-funds in the underserved sections of the economy and did not prefer an outright ban (other than prize chits, which were banned in 1978). The Government decided to regulate chit-funds through a central Act known as the Chit Fund Act, 1982 (CF Act).

Although the CF Act was enacted by the Parliament, it is implemented by authorities under the control and supervision of the State Governments. Moreover, several State Governments have enacted separate laws for protecting the interest of chit-fund subscribers and analogous depositors from time to time, contributing to further fragmentation of the legal regime. The Supreme Court has classified chit-funds as 'contracts', thereby subjecting them to the Concurrent List of the Constitution. As a consequence of such a fragmented approach, the legal regime for regulation of chit funds has not proved to be very effective in practice and several chit-funds continue to function without necessary permissions and compliances.

PROPOSED APPROACH

The improper regulation of chit funds and other analogous activities in India is attributable to the lack of ownership and coordination among relevant Central and State authorities, making the system susceptible to external interferences and capture. It is predicted that the political economy of States make State-level authorities particularly prone to capture by local interests, which may undermine the quality of regulation and enforcement. Such issues combined with the regulatory arbitrage opportunities created by multiplicity of laws on the subject have led to a series of scams over the years, affecting the lives of millions of subscribers. A unified, but cooperative approach is clearly the need of the hour.

IMPLEMENTATION

The Government should consider enacting a central legislation that consolidates and improves upon all existing Central and State laws on regulation of chit funds (and allied activities) and propose a unified central authority for its implementation. Given the prevalence of such financial activities in small towns and villages and the likelihood of criminal misconduct by those operating them, the involvement of State Governments including local law enforcement agencies in such central authority also assumes importance. Therefore, the proposed authority should have presence in all the States and use the combined synergies of the central financial sector regulators and the State Governments for better implementation of the law. This 'cooperative' approach may also militate against the possibility of 'regulatory capture' often associated with the present decentralised approach. Moreover, it is important to note that the 2008 report of Committee on Financial Sector Reforms stated that the regulatory obligations imposed on chit funds should not be so onerous as to render the business completely unviable. In addition to defragmenting the system, a unified and modern central law would also help in simplifying the regime. It would reduce the costs of compliance so that genuine chit funds or RoSCAs are able to fulfil their social function of encouraging savings and improving access to credit in underserved sections of the economy.

The improper regulation of chit funds in India is attributable to the lack of ownership and coordination among the Central and State authorities, making the system susceptible to external interferences and capture.

REGULATING MICRO-FINANCE

THE CONFLICT

Micro-finance is a critical social need in our country where more than three quarters of the adult population do not have access to basic formal financial services. The domain was originally occupied by indigenous individual money lenders, which later extended to micro-finance institutes (MFIs) functioning on a non-profit model, and is now dominated by profit making MFIs.

Till date, it is a poorly regulated sector with fragmented jurisdiction. The MFIs are either incorporated as non-banking financial companies (NBFC-MFIs) governed by the Reserve Bank of India (RBI), or are non-incorporated MFIs (societies, trusts, firms, individuals, etc.) falling within the ambit of State money lending laws. States have viewed both incorporated and non-incorporated MFIs as money lenders falling within their constitutional domain under Entry 30 of the State List ('Money-lending and money-lenders'). This is evidenced by the draconian legislation notified by the State of Andhra Pradesh which led to the MFI industry in the State going out of business in 2010.

To address this situation, the Centre has proposed the Micro Finance Institutions (Development and Regulation) Bill, 2012 (MFI Bill), presumably under Entry 43 (relating to banking, insurance or financial corporations) or Entry 45 ('Banking') of the Union List. It originally designated the RBI as the single regulator for micro-finance activities of all kinds of MFIs other than individual money-lenders. The Bill also provided for over-riding of State laws.

It is understood that in the revised draft of the MFI Bill, the RBI is being replaced by the already functional Micro Units Development & Refinance Agency Limited (MUDRA Bank) which will act as a unified independent regulator for the micro-finance sector. However, there is no clarity on whether existing State laws will be over-ridden. The existence of State legislations as well as a central law for the same activity will result in an uncertain legal regime fraught with legal challenges.

The core principle for regulation of this sector should be to regulate the activity of micro-finance in a uniform manner, irrespective of the legal nature of the entity carrying out the micro-finance related activities.

PROPOSED APPROACH

The core principle for regulation of this sector should be to regulate the activity of micro-finance in a uniform manner, irrespective of the legal nature of the entity carrying out the micro-finance related activities. The existence of overlapping Central and State laws governing non-incorporated MFIs, will result in conflict and uncertainty, which may be put to rest on the following reasoning:

- The State has constitutional jurisdiction over money-lenders and money-lending, which are factually and traditionally distinct from MFIs. The former refers to individual usurious money lenders functioning informally and providing only microcredit and the latter to formal registered micro-finance institutions providing other financial services like micro-insurance, micro-savings, transfer of money in addition to micro credit,
- The expansion of the scope of MFIs under the MFI Bill makes it more akin to 'banking' as it captures the full suite of financial services as opposed to only micro-credit, and thus,
- With the application of the doctrine of pith and substance, the subject of micro-finance is better classified as 'banking' under Entry 45 of the Union List.

IMPLEMENTATION

The MFI Bill, therefore, should be amended to provide for the following:

- A single central regulator to regulate NBFC-MFIs as well as non-incorporated MFIs (excluding individual money lenders) functioning through efficient State and district agencies (to be mandatorily set up),
- A clause over-riding all State laws to facilitate the uniform and structured growth of the sector; and
- A clear separation of the regulation function and financing function of the said regulator to obviate internal conflicts.

The suggested amendments require being implemented clearly in the Centre's domain of 'banking' to obviate legal or operational challenges. Such an amended MFI Bill will help the micro-finance industry regain the legitimacy it lost in the process of State regulation. It will also provide clarity, certainty and comprehensiveness in respect of the governing law for all MFIs across the country. With the right regulation, the micro-finance industry can become a power house of resources to the poor who do not have access to traditional banking.

THE PUBLIC TRUST

NATURAL RESOURCES

The field of resource management in India has been riddled with thorny issues over the years — be it instances of illegal mining, of inordinate delays in securing environmental clearances, ever-contentious inter-state water disputes, or failure to cope with mass deforestation and environmental pollution. Resources thus pose a complex challenge in any federal structure owing to the high stakes involved — in terms of their massive revenue potential, fiscal health of individual States, and public interest and involvement. This therefore is an area where cooperative federalism is most likely to break down.

Natural resources are viewed as belonging to the community at large and not specific entities — a sentiment echoed through the Constituent Assembly Debates, and enshrined in the Constitution as the principle of 'best subserving the common good'. 'Common good' however may have different connotations for the Centre and individual States.

Rethinking possible solutions leads to either vociferous calls for increased centralisation of power, or the opposite, devolution of power to local bodies. Given that the impact of resource exploitation is most severely faced by States, a strong case is made out for decentralisation of power. This is especially true in the context of environmental issues since it is the States that are left to grapple with the effects of resource utilisation, and may be best placed to formulate local area-specific solutions and secure local participation. However, excessive State control runs the risk of intensifying horizontal imbalances resulting from uneven distribution of resources across States. For instance, leaving collection of revenues from resources entirely to the will of an individual State could lead to massive fiscal imbalances and distortions. Excessive powers to individual States could also lead to conflicts or friction between them where use of a resource results in spillovers beyond such State's boundaries, or where a resource is shared between States (for instance, inter-state rivers).

While control over most resources has been distributed in the Constitution between the Centre and the States, new arrangements through legislative or executive power or through judicial decisions, have evolved over time and should continue to evolve to address changing needs. With this objective in mind, this section explores a few contentious issues that have arisen in the management of specific individual resources, which in our view, could be addressed differently for more effective resource federalism. These issues typically stem from vertical imbalances, i.e. uneven power between the Centre and the States, and States and local governments, or from horizontal inter-state disputes or conflicting interests that require new interventions or mechanisms for resolution.

For example, land acquisition has traditionally been a hotly contested Centre-State issue, exacerbated even further by the seemingly hurried promulgation of the Amendment Ordinance 2014. With the Centre now abandoning key amendments and instead looking to the States to expedite development, the manner in which States proceed and the extent to which they can derogate from the Central law is open to debate.

A vital resource over which the Centre and States have been at loggerheads is power, with several States drawing the ire of the Centre due to their routine and repeated attempts to obstruct the achievement of an open access regime in the country.

In contrast to the above set of issues, largely arising out of vertical imbalances, are inter-state water disputes that have been bitterly fought in our presently-adversarial adjudicatory mechanism. A different approach — one more conciliatory than the existing structure — may prove feasible and more attuned to securing lasting solutions.

A different, but related aspect of the 'public trust' is protection of the environment. Processes for environmental clearances, Environment Impact Assessments, forest diversion and compensatory afforestation all suffer from issues related to inadequate coordination between State and Central authorities, fuelled by conflicting sets of interests.

While the Centre and States are given primacy in such resource conflicts, the third tier of government, being the closest representatives of local communities, deserve recognition as equal stakeholders in resource management. With regard to mining, the introduction of 'District Mineral Foundations' to be constituted for the benefit of mining-affected persons and areas, is certainly a welcome step. Concerns have, however, been raised regarding capacities of States to formulate effective frameworks for their administration without adequate guidance.

Given the tremendous levels of historical perspective associated with each of the above, any step forward should necessarily involve widespread consultation, in addition to cooperation and coordination amongst the Centre, States and local governments — the hallmark of cooperative federalism. Potential solutions to resolve these conflicts accompanied by concrete measures for their implementation have been discussed over the next few pages.

FEDERALISING LAND ACQUISITION LEGISLATION

THE CONFLICT

The Centre's latest move in the political logjam around the Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act, 2013 (the Central Act), has been to look to the States. Abandoning the key provisions in its proposed amendments, the Centre has, sources say, suggested that States should enact their own land acquisition laws to expedite development, indicating that such laws would readily receive Presidential assent.

Questions have been raised, however, on whether derogation by States will be constitutional, and if so, what provisions States should derogate from. Can States completely replace the Central Act, or amend it to any extent? Those answering in the negative point to Section 107 of the Central Act which permits States to amend the law only to enhance entitlements, and prohibits lowering any entitlement or removing any safeguard. Under these circumstances, will Section 107, or any other legal provision, prevent States from substantially amending the Central Act?

The Constitution under Article 254(2) clearly lays down that a State law under the Concurrent List that has received Presidential assent will prevail in that State, notwithstanding its repugnancy to an earlier Union law on the same subject. This being the only Constitutional requirement, it seems likely that as long as the President assents (although there may be questions around how the power of Presidential assent may be validly exercised), no other provision, such as Section 107 of the Central Act, will stand in the way of State amendments. Such amendments may, therefore, amend the Central Act to any extent, or perhaps even replace it.

However, the strong opposition and political conflict surrounding land acquisition legislation is not likely to dissipate merely because the stage shifts from the Centre to the State. A case in point is the set of amendments to the Central Act that the State of Rajasthan sought to introduce, seeking to do away with Social Impact Assessment (SIA). This attempt failed even before it reached the stage of Presidential assent, due to opposition within the State.

Therefore, even if States are now legally empowered to amend the Central Act, they must carefully consider what amendments, if any, are best suited, and have the greatest chance at addressing current problems with the Central Act as well as being acceptable politically.

THE APPROACH

Presently, given the recent failure in trying to dilute consent and SIA provisions, it may be inferred that the Centre would look to States to address the same issues. Various stakeholders, including industries have repeatedly said however, that it is not SIA or the amount of compensation that is the real challenge — it is the lengthy timeline of the acquisition process and the complicated nature of the Central Act. States should therefore use this opportunity to reduce the lengthy timeline of the acquisition process, rectify numerous drafting errors and better operationalise consent provisions, while refraining from removing any entitlements or safeguards under the Central Act.

IMPLEMENTATION

State legislatures should address the aforementioned problems in the following manner:

- At present it takes 50 months to complete an acquisition, which benefits no one. This problem can be addressed in two ways, first, by reducing authorities that duplicate functions. For instance, since the SIA is conducted by an independent organisation, review of the same by an expert group only adds to the timelines. Such a requirement should therefore be deleted from the legislation. Second, certain procedures should be conducted simultaneously to expedite acquisition. For instance, multiple hearings under the Central Act should instead be combined wherever possible. These steps will reduce the time taken for acquisition considerably.
- While provisions relating to consent have been among the most controversial aspects of the Central Act, relatively little attention has been paid to the manner in which it is to be operationalised to ensure consent is free, prior and informed. Questions such as the manner in which consent-givers are to be identified in case of disputed lands, for example, remain unanswered. States should focus on this aspect if they choose to bring in amendments.
- Drafting errors within the Act have the potential to create interpretive ambiguities and obstruct the implementation of the legislation. While the proposed amendments to the Central Act have addressed a few, other crucial ones remain that should be rectified at the earliest opportunity.

States should therefore use this opportunity to reduce the lengthy timeline of the acquisition process, rectify numerous drafting errors and better operationalise consent provisions, while refraining from removing any entitlements or safeguards under the Central Act.

STRENGTHENING THE ENVIRONMENT IMPACT ASSESSMENT PROCESS

THE CONFLICT

The optimum division of powers between the Union Ministry of Environment, Forests and Climate Change (MoEFCC) and the State Environment Impact Assessment Authorities (SEIAAs) regarding the grant of environmental clearances has been a matter of contention since the first Environment Impact Assessment (EIA) Notification was issued in 1994. Depending upon the type and scale of the project, the EIA Notification 2006 requires that certain projects (Category A) require Central clearance, while others (Category B) need only be assessed at the State level.

States have pressed for the expansion of Category B on the grounds that they are better equipped to judge local conditions. However, environmentalists have expressed concern over the impartiality of this decision-making process because of the States' interest in attracting investment. With the Centre increasingly expanding the powers of SEIAAs, there are greater chances of inconsistency in the review process across States, particularly a lowering in its quality, in a bid to appear investor-friendly.

Another source of inconsistency is the fact that projects promoted by State Governments may ultimately be rejected by the Centre that retains the power to grant forest clearances to projects above a certain threshold. Inadequate coordination between SEIAAs and Central forest clearance authorities has meant that proponents have often commenced operations after obtaining only one clearance, thus causing irreparable environmental damage. Given the levels of investment involved, once one of the clearances has been obtained, the other authority is under considerable pressure to similarly grant approval, compromising the independence of the review process.

PROPOSED APPROACH

The solution does not lie in taking powers away from the SEIAAs and giving them to the MoEFCC at the Centre instead, since the latter does not have a good decision-making record either. Civil society activists, academics and State Governments themselves have suggested a number of approaches to improve the quality of the EIA process. These include a clearer demarcation between Category A and Category B projects (Kohli, 2006) as well as the creation and strengthening of new Central and State regulatory authorities (Ghosh, 2014). These alternate recommendations will work well only when the decision-making authorities (both at the Central and State levels) are made to enforce consistent and rigorous environmental protection standards through a combination of incentives and legal requirements.

IMPLEMENTATION

- *Allocating resources for capacity building on the basis of the environmental performance record of SEIAAs*

Currently, State Governments bear the financial expenses of SEIAAs. The Fourteenth Finance Commission has recommended partial linking of tax distribution among States to the protection of forest cover. Along similar lines, an initial grant ought to be made by the Centre to all States to supplement SEIAA expenditure, on the basis of the volume of clearances reviewed by each SEIAA. A performance evaluation framework, similar to the Results-Framework Document used by the MoEFCC ought to be evolved to test the quality of the review process. Additional funds ought to be allocated using this framework, with States being permitted to use these also for monitoring and compliance.

- *Defining standards to be observed by SEIAAs during the review process*

The current EIA Notification contains a check-list of factors that project proponents must submit to demonstrate the environmental impact of their project. However, SEIAAs are not required to demonstrate the manner in which they take these factors into consideration. The EIA Notification should clearly set out the manner in which SEIAAs ought to balance competing interests, similar to the Forest (Conservation) Rules, 2003. They should also furnish detailed reasons for their decision. These recommendations also ought to apply equally to Central authorities that review Category A projects. Additionally, SEIAAs should be granted the flexibility to impose stricter requirements on project proponents than those required by the Centre.

- *Adopting a holistic review process*

When a new regulatory authority is created to subsume current bodies, environmental and forest clearance processes also ought to be integrated. Authorities will then be able to review projects with complete information, free from the pressure to grant approval because of the approval already granted by another body.

Inadequate coordination between SEIAAs and Central forest clearance authorities has meant that proponents have often commenced operations after obtaining only one clearance, thus causing irreparable environmental damage.

TIGHTENING FOREST DIVERSION AND COMPENSATORY AFFORESTATION PROCESSES

THE CONFLICT

Although 'Forests' are on the Concurrent List, under the Forest (Conservation) Act, 1980 (FCA), the power to divert forest land for non-forest purposes is concentrated in the Centre. Such diversion requires Central approval under the FCA although States are involved in crucial parts of the process such as acquiring non-forest land for compensatory afforestation (CA) in lieu of the land diverted.

Irregularities persist despite this centralisation and close monitoring by the Supreme Court (SC) in *T.N. Godavarman Thirumulkpad* v *Union of India*. A compliance audit conducted by the Comptroller and Auditor-General of India (CAG) in 2013 censured both the MoEFCC and State Governments for the many legal violations that it revealed.

The former was censured for its failure to monitor compliance with the conditions attached to forest clearances; the latter for their failure to make land available for CA by appropriately transferring and mutating it in the revenue and forest records, and for the non-utilisation of funds released to them by the Central, ad hoc Compensatory Afforestation Management and Planning Authority (CAMPA). The CAG report also revealed the lack of coordination between the MoEFCC and the State Forest Departments, with significant discrepancy in the records maintained by them.

Although the CAG Report repeatedly emphasises that ultimate responsibility for compliance with the forest clearance process vests with the MoEFCC, it is evident that oversight is difficult, given the diversity of State Acts and procedures involved. Successful implementation of the FCA thus requires the active support of State authorities.

PROPOSED APPROACH

The Compensatory Afforestation Fund Bill (CAMPA Bill) introduced in the Lok Sabha in May 2015 partially addresses the concerns raised in the CAG report. It sets up permanent Central and State authorities to receive and disburse CA funds and a national monitoring group of experts to evaluate CA schemes. However, the focus of the CAMPA Bill is on CA schemes undertaken after forest clearance has been granted. What is additionally required is making forest diversion itself more strictly contingent on certain conditions related to CA being in place a priori. This will also require a clearer demarcation of duties between Central and State authorities through legal instruments rather than the current MoEFCC guidelines.

IMPLEMENTATION

The CAMPA Bill as well as the Forest (Conservation) Rules, 2003 (FCA Rules) require amendment to incorporate the following:

- *Creating coordinated Central and State databases on the status and availability of forest and non-forest land*

A comprehensive database that maps the total area, different categories, legal status and availability of forest and non-forest land would be useful not only in monitoring CA works, but also in making prior decisions about forest clearances. This database could be an expanded version of the e-Green Watch System of the MoEFCC that lists projects already granted approval. The Forest Survey of India could conduct this mapping exercise, in consultation with State Forest and Revenue Departments. This database should form part of the public information system proposed under the CAMPA Bill and also ought to be used to implement the Forest Rights Act, 2006.

- *Requiring the transfer and mutation of non-forest land before approval for the diversion of forest land is granted*

Currently, the guidelines issued by the MoEFCC require non-forest land identified for CA to be transferred to State Forest Departments and declared as Reserved/Protected Forests before a project may be commenced. This should be made a legal condition under the FCA Rules, and the Nodal Officer of the State Government ought to furnish evidence of this transfer and mutation to the MoEFCC as a part of the forest diversion proposal submitted for approval. Different administrative procedures adopted by different States for such transfer and declaration make this a time-consuming process (CAG Report, 2013). A uniform, model procedure ought to be framed for adoption.

- *Imposing a joint legal duty on appropriate Central and State authorities to monitor compliance with conditions*

The CAMPA Bill creates a group of six experts to evaluate CA works in different States. This group should also monitor compliance with additional conditions imposed by the MoEFCC while granting forest clearances and should involve relevant State authorities (likely to have better knowledge of local conditions) in this monitoring process.

Rather than relying on the MoEFCC to issue instructions to States on the implementation of the FCA, these steps create clear legal obligations for State authorities and make the Ministry's task more manageable.

Forest diversion procedures require a clearer demarcation of duties between Central and State authorities through legal instruments.

OVERHAULING ADJUDICATION OF INTER-STATE RIVER WATER DISPUTES

THE CONFLICT

The availability and allocation of water resources is one of the most vital issues that face any nation. In India, river water disputes have the ability to arouse extreme public emotions and have therefore historically resulted in heated political battles. Contesting States engage in public posturing by staking maximum claims, delaying the adjudication or disrespecting the decisions of the tribunals. This makes the rational resolution of such contentious disputes virtually impossible.

At present, river water disputes are adjudicated under the provisions of the Inter-State River Water Disputes Act, 1956 (ISWD Act). There are five separate inter-state water disputes tribunals functioning currently in India. The present mechanism of adjudication has been criticised widely for three chief reasons. First, it is fraught with enormous delays which occur at almost every stage. Second, the adversarial nature of proceedings adopted by the tribunals is divisive and does not explore alternate avenues to resolve differences. It leads to one or more parties 'losing' when the final decision is arrived at. This in turn makes ensuring compliance with the award extremely difficult. Third, the most difficult problem with the existing system is the fact that there is no way to ensure the actual implementation of the awards of the tribunals.

PROPOSED APPROACH

At the heart of this situation is the fact that the adversarial nature of the proceedings does not provide political incentive for quick and effective resolution. Many believe that given the distinct character of river water disputes, negotiation and conciliation are better ways to arrive at a lasting solution. Given the growing disenchantment, it is imperative to reorient our entire approach to inter-state water disputes and rework the flawed dispute resolution mechanism currently in place. It is therefore recommended that the institutional set up which seeks to resolve inter-state river water disputes has to incorporate the following: first, a solution-seeking and conciliatory approach instead of an adversarial one; second, a mechanism that curbs the delays in the adjudication process and third, a monitoring mechanism post declaration of award which ensures that States abide by the decisions of the tribunals.

At the heart of this situation is the fact that the adversarial nature of the proceedings do not provide political incentive for quick and effective resolution.

IMPLEMENTATION

The present system of ad hoc tribunals under the ISWD Act should be replaced by a new law which encapsulates the four-fold framework described below.

- *Mandatory one year mediation before reference to tribunal*

This is similar to the process adopted by United States where a Special Master is appointed to resolve river disputes through a consultative and exploratory approach. The success of the Indus Waters Treaty, 1960 between India and Pakistan through mediation by the World Bank also points to the effectiveness of conciliatory proceedings.

- *Setting up of a Permanent Inter- State River Water Disputes Tribunal*

When attempts to arrive at a solution through mediation fails, adjudication becomes unavoidable. A single permanent tribunal will address the inordinate delay that is caused in setting up ad hoc tribunals each time a dispute arises. The contesting States should be allowed to file for resolution before this tribunal if they are unable to arrive at a solution through mediation. (For further suggestions on the structuring the permanent tribunal, see Vidhi, 2014).

- *Regular audits to monitor compliance with awards*

The Central Water Commission, established under the Ministry of Water Resources, should be tasked with conducting regular independent audits and submitting reports to the tribunal regarding State compliance with awards. This will address the third concern raised above and ensure effective implementation of the decisions of the tribunal.

- *Pre-legislative consultation*

Given the political nature of inter-state water disputes, consultation between the Centre and the State Governments before effecting any change in adjudicatory process is critical to ensure future cooperation from the States. Although the Inter-State Council would be the ideal body to conduct such consultation, given its dormant state it is suggested that an ad-hoc inter-state consultation committee should be constituted to build consensus regarding the details of this legislation, along the lines of the Empowered Committee created for enactment of law introducing the Goods and Services Tax. This will go a long way in ensuring compliance with the newly enacted legislation.

UNLOCKING THE POWER SECTOR

THE CONFLICT

Power sector issues in India are not merely regulatory in nature, they are also intensely political, typically involving Centre–State tussles. Due to such tussles, power sector reforms have always been difficult to achieve in India. An apt example is the open access regime under the Electricity Act, 2003 (EA), which remains largely unfulfilled due to conflicting State interests. Open access forms part of the philosophical foundation of the EA which aims to induce competition in the electricity sector. The basic idea is to ensure that electricity generators and the consumers have unhindered access to transmission and distribution networks in a non-discriminatory manner.

However, artificial constructs have been adopted by States to block open access, including:

• Imposition of prohibitive and exorbitant cross subsidy charges (CSS) and other additional charges which deter consumers from purchasing power from outside the State;

• Deliberate delay by the State Load Despatch Centres (SLDC) in disposing open access applications; and

• Invocation by the States of the emergency powers under Section 11 of the EA to impose bans on supply of electricity by power generating stations in the State to consumers outside the State. The Supreme Court is currently examining the validity of the exercise of this power of invoking "exceptional circumstances" under Section 11 of the EA and restricting open access.

Such counter-productive acts have not only garnered heavy criticism from the Central Government but have also delayed creation of a market-driven electricity sector which encourages competition amongst suppliers and improves quality and pricing of electricity. Further, these measures have also restricted transfer of power from surplus to deficit regions and stifled the growth of the power sector as a whole.

PROPOSED APPROACH

A successful open access regime can only be achieved by ensuring that the State Governments also commit to the implementation of this regime. The EA empowers the State Electricity Regulatory Commission to impose CSS on open access procurement in order to compensate for the losses to the distribution licensee due to industrial consumers procuring electricity from an independent generator under the open access regime. Whilst imposition of CSS is justified, reports reveal that State Governments have not worked towards reduction of CSS, which is also mandated under the EA. The electricity markets will be truly open only when CSS is reduced and procuring electricity from the open access markets is not commercially unfeasible.

IMPLEMENTATION

First, the formula for calculation of CSS prescribed in the National Tariff Policy has not been adopted uniformly by the States. A uniform CSS formula which is both acceptable to the States and is consumer friendly will need to be arrived at through Centre-State consultation. Further, a road map for gradual reduction of CSS should be prepared and complied with by the State Governments.

Second, implementation of open access also depends on the organisational and infrastructural capabilities of the SLDC. Therefore, the State Governments should work towards setting up SLDCs as independent bodies with financial and operational autonomy. Administrative and technical assistance in this regard should be provided by the Central Government.

Third, the interpretation of the term 'exceptional circumstances' under Section 11 of the EA by the Supreme Court will throw much needed light on the extent of the powers of the State Government. The Advisory Group constituted for Integrated Development of Power, Coal and Renewable Energy recommended restricting the authority of the State Governments to issue directive to prevent open access. Whilst a blanket ban on the State's powers to prevent open access may be viewed as contrary to the spirit of federalism by the States, it may be worthwhile to consider restricting the powers of the State under Section 11 to ensure that arbitrary actions with the sole purpose to restrict open access cannot be taken.

The electricity markets will be truly open only when cross subsidy charge is reduced and procuring electricity from the open access markets is not commercially unfeasible.

STREAMLINING THE FUNCTIONING OF DISTRICT MINERAL FOUNDATIONS

THE CONFLICT

Mineral resources ought to be a source of wealth for the States in which they are located and for the communities most closely connected to them. This, however, proves to be an exception rather than the norm, with most mineral-rich States suffering from what is popularly known as the 'resource curse' and the local communities often being the worst affected, left to deal with after-effects of resource depletion. Cooperative federalism in the management of resources should entail not merely increased powers to States but also strengthening of local communities and institutions through a bottom-up approach. A recent step in this direction was the introduction of 'District Mineral Foundations' (DMFs) through an amendment to the Mines and Minerals (Development and Regulation) Act, 1957 (MMDR Act).

DMFs are non-profit bodies to be constituted by the State Governments in each district affected by mining related operations. In case of major minerals, miners are required to pay to the DMF an amount not exceeding one-third of royalty payable, for leases granted after the amendment. Each State is to determine the manner in which a DMF would work for the benefit of persons and areas affected by mining operations. The composition and functions of the DMFs are also left entirely to the discretion of States, with the sole caveat that they follow existing law with regard to Scheduled Areas. Interestingly, despite the apparently clear mandate to States, the Centre still retains indirect supreme control through insertion of a new provision that enables it to issue directions to the States on inter alia any policy matter in national interest.

The framework envisaged for DMFs, in its existing form, runs the risk of maladministration inasmuch as it fails to provide adequate guidance with respect to a DMF's composition, powers and functions, and falls short of institutionalising local involvement. While most States are yet to frame rules for DMFs, the draft rules formulated by Rajasthan are an indicator that some guidance would be welcome. DMFs may potentially receive huge amounts as funds, especially in light of the recent hike in royalty rates for major minerals, making it all the more crucial to provide for optimum utilisation of the funds collected.

PROPOSED APPROACH

While the grant of discretion to States is ostensibly in keeping with the spirit of cooperative federalism, rehabilitation and development of mining-affected areas would be better served through an effective framework for DMFs with guidance on certain crucial aspects, while leaving enough discretion for States to tailor institutions to suit local needs. Instead of sole State control or supreme Central control, a cooperative approach may be adopted with the guiding principles being recognition of mining-affected persons and local communities as equal stakeholders in resource management, and enabling a transparent, effective framework for the functioning of DMFs.

IMPLEMENTATION

Certain provisions such as inclusion of district panchayat/ district council member, and audit of DMF's accounts, should ideally be set forth in the MMDR Act itself — however, since a further amendment to the Act is not presently foreseeable, the following steps may instead be taken.

- *Model rules for guidance*

The 'Draft DMF Trust Deed' framed by the Union Ministry of Mines (recently released as a model for DMFs) could be further enhanced through inclusion of additional provisions, such as the scope of 'persons and areas affected by mining related operations', the process of identification of such persons, and representation of local governments/ affected persons in the DMFs. This would ensure a degree of uniformity in the understanding of crucial concepts and serve as an indicator that States should necessarily formulate rules for these concepts.

- *Adopting a consultation process while formulating rules*

States should finalise rules only after consultation with stakeholders, including local governments and local communities. Given that their involvement is not mandated in the MMDR Act, such consultation is, at the very least, expected to allow local bodies representation in rule-making.

- *Ensuring a transparent framework*

A mechanism for periodic monitoring should be built in by States through involvement of gram sabhas or other local governing bodies. In addition, surprise checks and audits could be directed by the Union Ministry of Mines. States should also prescribe rules in respect of audit of a DMF's accounts and for laying of the accounts before the State Legislature. Details regarding receipt and utilisation of funds by each DMF should be made open to public access and scrutiny.

Rehabilitation and development of mining-affected areas would be better served through an effective framework for DMFs with guidance on certain crucial aspects, while leaving enough discretion for States to tailor institutions to suit local needs.

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