



# Vidhi

Centre For Legal Policy

BETTER LAWS. BETTER GOVERNANCE

# RESEARCH REPORT ON QUERIES RAISED BY THE FOURTEENTH FINANCE COMMISSION

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## 3. ON THE INTER-STATE COUNCIL

Srijoni Sen  
Shubhangi Bhadada

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## INTRODUCTION

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One of the main functions of the Planning Commission is to co-ordinate the allocation of financial resources in the form of grants to States to finance plans and schemes. With the Prime Minister announcing the dismantling of the Planning Commission,<sup>1</sup> it is important to explore the options available to ensure the smooth transition of this function into the hands of another body. This note looks at the option of the Inter-State Council ('ISC'), a body comprising State and Centre representation, taking over the functions of recommending the manner in which allocation of financial resources to the States should be carried out. The chief merit of such a proposal would be that it would ensure greater participation of the States in the process of grants being made by the Centre. In this context, the query that has been raised by the Fourteenth Finance Commission for our consideration:

1. In what way can the Inter-State Council be strengthened or organised to take over the functions of allocation of financial resources currently dispensed through the Planning Commission?

In this note, our main recommendation with regard to the above mentioned query is the following:

The ISC should be strengthened in order to play an effective consultative role in the task of financial allocations, while the primary decision making process should remain in the domain of the Central Government.

In this regard, Section 1 of this note looks at the financial allocations currently being made by the Planning Commission to States and the constitutional basis for the same. Section 2 looks at theoretical perspectives and various institutional designs internationally for making grants to States from Central Governments. Based on this, Section 3 outlines a recommendatory role that the ISC can play in the allocation of finances. Section 4 of this note suggests ways to strengthen and organise the ISC, so that it can effectively play this role. Lastly, Section 5 summarises and concludes this Note.

### 1. Constitutional position

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The Constitutional scheme for grants made by the Centre to the States is laid out in Part XII of the Constitution. Article 275 introduces the concept of 'for grants-in-aid of the revenues' of States, and provides that Parliament may fix different grants-in-aid to different States after considering the recommendations of the Finance Commission. According to Article 280, which sets up the Finance

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<sup>1</sup> Suvojit Chattopadhyay, 'Disband the Planning Commission, focus on states instead' (23 September 2014) available at <<http://www.livemint.com/Home-Page/vOYwMl4hgXSVXYGoKVsw7N/Disband-the-Planning-Commission-focus-on-states-instead.html>> accessed on 27 September, 2014; Also see "Replacement of Planning Commission still under consideration", *Zee News India* (21 September, 2014) available at <[http://zeenews.india.com/news/nation/replacement-of-planning-commission-still-under-consideration\\_1473443.html](http://zeenews.india.com/news/nation/replacement-of-planning-commission-still-under-consideration_1473443.html)> accessed on 27 September, 2014.

Commission, the body is charged with recommending to the President 'the principles which should govern the grants-in-aid of the revenues of the States out of the Consolidated Fund of India'.

From this, it seems fairly clear that grants by the Central Government to the State Governments must be made on the recommendations of the Finance Commission. Planning Commission and other Ministry grants, however, are made under Article 282, which reads

“The Union or a State may make any grants for any public purpose, notwithstanding that the purpose is not one with respect to which Parliament or the Legislature of the State, as the case may be, may make laws.”

Through the channel of Article 282, the Planning Commission has co-ordinated the grants from Centre to States under the Annual Plan, which determines the allocation of resources between various Central and State departments and agencies for the implementation of the broad objectives of the Five Year Plan. The budgetary allocations to States under the 2013-14 Annual Plan as part of Central Assistance consisted of Rs. 1.4 lakh crores. In recent years, about half of the total grants made by the Centre to the States has been channelled through the Planning Commission.<sup>2</sup> Of this, over time, the share of discretionary or non-formula grants by the Planning Commission has increased to over 70% of the total Central plan assistance to States.<sup>3</sup>

Much has been written about the lack of Constitutional status of the Planning Commission.<sup>4</sup> In addition, the use of Article 282 to make grants that are not based on the recommendations of the Finance Commission has been the subject of much debate.<sup>5</sup> The Supreme Court has also weighed in on the issue

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<sup>2</sup> According to the RBI Report on State Finances, the total grants in 2011-12 from Centre to State was 1864.2 billion rupees. According to the Annual Plan published by the Planning Commission, the total Plan Central Assistance in 2011-12 was 104015.9 crore, which works out to about 56% of the total Central Grants. See *State Finances: A Study of Budgets of 2013-14*, RBI, 83 ('State Finances: A Study of Budgets of 2013-14') available at <<http://www.rbi.org.in/scripts/AnnualPublications.aspx?head=State%20Finances%20:%20A%20Study%20of%20Budgets>> accessed on 26 September, 2014; Planning Commission of India, 'Annual Plan 2013-14', 6, available at <[http://planningcommission.nic.in/plans/annualplan/annual\\_plan13\\_14.pdf](http://planningcommission.nic.in/plans/annualplan/annual_plan13_14.pdf)> accessed on 26 September, 2014.

<sup>3</sup> Reserve Bank of India, *State Finances: A Study of Budgets of 2013-14* at 5.

<sup>4</sup> See, for example, HK Paranjape, 'The Task of the Ninth Finance Commission: The Planning Commission Tangle', in *The Ninth Finance Commission: Issues and Recommendations* (NIPFP, 1993); 'Note of Shri NC Jain on Restructuring: Suggestions for some Constitutional and Legal Changes' in Report of the Eleventh Finance Commission for 2000-2005, available at <[http://fincomindia.nic.in/writereaddata/html\\_en\\_files/oldcommission\\_html/fcreport/11threport.pdf](http://fincomindia.nic.in/writereaddata/html_en_files/oldcommission_html/fcreport/11threport.pdf)> accessed on 26 September, 2014.

<sup>5</sup> This issue has especially been discussed in detail in the First Administrative Reforms Commission, the Fourth Finance Commission and the Ninth Finance Commission Reports. The question being considered was whether Article 275 dealt only with revenue grants, since the phraseology used therein was 'grants-in-aid of revenue', while Article 282 gave residuary grant making powers to the Union and States in their discretion. Eminent jurists such as M.C Setalvad, P.V. Rajamannar, Nani Palkhivala, A.G. Noorani and KK Venugopal have provided differing views on this matter over the years. See HK Paranjape, 'The Task of the Ninth Finance Commission: The Planning Commission Tangle', in *The Ninth Finance Commission: Issues and Recommendations* (NIPFP 1993).

in *Bhim Singh v. Union of India*<sup>6</sup> where it said that Article 282 could be the source for ‘emergent transfer of funds’, and restrictions could not be placed on the scope of Article 282 by reference to other articles or provisions.

The extensive use of Article 282 as the main channel of grant-making has also been criticised on the ground that it has led to overly centralised fiscal relations.<sup>7</sup> However, regardless of whether Article 275 or Article 282 is used as a channel for grant-making, the Constitution does not explicitly provide for a role for States in this matter. The question of State involvement in fiscal transfers was considered during the drafting of the Constitution. The Expert Committee on the Financial Provisions of the Union Constitution, appointed by the Constituent Assembly in September, 1947, recommended that two of the five members of the proposed Finance Commission be nominated by the States, two from a panel nominated by the Central Government while the President would appoint the Chairman.<sup>8</sup> This suggestion of the Expert Committee, to have representation from the States in the Finance Commission, was ultimately not adopted by the Constituent Assembly.<sup>9</sup> Conflicts between Centre and the States, or between States, were left to be resolved through an Inter-State Council that could be appointed under Article 263, the terms of which were widely worded.

Therefore, the Constitution does not explicitly provide for the involvement of States in the process of financial allocations. However, accepted theories of institutional design, as well as international practice indicate the need for State units to play a role in the decision-making process for fiscal allocations from Centre to State. This will be discussed in more detail in the next section.

## 2. Institutional Theory and International Best Practices

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The first principle that emerges from a study of scholarly work on fiscal transfer mechanisms is that there should be clarity in the system of assignments, based on principles that are set at the stage of constitution-making.<sup>10</sup> Rather than purely discretionary allotments made by a Central Government, “jurisdictional boundaries and the assignment of functions and finances have to be taken as determined

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<sup>6</sup> (2010) 5 SCC 538.

<sup>7</sup> M. Govinda Rao, Nirvikar Singh, *Political Economy of Federalism in India* (OUP 2005) 198.

<sup>8</sup> Report of the Expert Committee on Financial Provisions, December 5, 1947 in *The Framing of India’s Constitution: Select Documents Vol. 3* (B Shiva Rao ed., New Delhi: Universal Law Publishing, 2012).

<sup>9</sup> Constituent Assembly Debates, 9<sup>th</sup> August 1949 available at <<http://parliamentofindia.nic.in/ls/debates/vol9p9a.htm>> accessed on 25 September, 2014.

<sup>10</sup> M Govinda Rao and Tapas K. Sen, ‘Federalism and Fiscal Reform in India’ NIPFP Working Paper No. 2011-84, 2011 available at <[http://www.nipfp.org.in/media/medialibrary/2013/04/wp\\_2011\\_84.pdf](http://www.nipfp.org.in/media/medialibrary/2013/04/wp_2011_84.pdf)> accessed on 25 September 2014.

at some earlier (constitutional) stage and not open to further discussion in normal circumstances”.<sup>11</sup> Thus, adherence to constitutional norms is critical to a well-designed system of fiscal transfers.

The second principle articulates the need to consult State units in the determination of fiscal transfers.<sup>12</sup> This is a crucial element of co-operative federalism, which requires continuous consultations on issues that affect the interests of Central and State Governments. Institutionalised channels of consultation are given importance in recognition of the fact that governmental actions affect other governments, and therefore exchange of views and information before acting is necessary, although the action of each government is taken independently.<sup>13</sup> By way of implementation of this principle, the World Bank recommends, as a ‘good practice to strive for’, the establishment of an inter-governmental forum to achieve consensus on the standard of equalisation and the objectives and designs of all fiscal transfer programs.<sup>14</sup>

A survey of institutional solutions in different countries establishes that almost all federal countries have inter-governmental institutions to facilitate consultation and collaboration, even if it is not mandated by the Constitution or by law. In some cases, these inter-governmental arrangements are set up explicitly with detailed rules and commitments, while in others, they have developed as a matter of convention.<sup>15</sup> Arrangements vary from a Council of State Governments acting as the Upper House of Parliament, as in Germany, to annual meetings of the provincial heads of government, as in Canada. In most cases, inter-governmental consultation is assisted by a permanent secretariat which provides technical assistance.<sup>16</sup>

The success or failure of these inter-governmental forums depends on a number of factors that impact their effectiveness and efficiency, including the degree to which the executive branch dominates inter-governmental relations, and the number of units in a federation. With smaller units, more ad hoc and informal bargaining may be pursued, whereas if the federation consists of a large number of units, more formal institutions will have to be established to ensure efficient cooperation. These formal arrangements may be instituted by law where constitutional amendment is difficult.<sup>17</sup> In South Africa,

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<sup>11</sup> Bird, Richard M., and Michael Smart, ‘Intergovernmental Fiscal Transfers: Some Lessons from International Experience’ (World Bank 2001).

<sup>12</sup> Anwar Shah, ‘Institutional Arrangements for Intergovernmental Fiscal Transfers and a Framework for Evaluation’, in Robin Broadway and Anwar Shah eds., *Intergovernmental Fiscal Transfers: Principles and Practice* (World Bank 2007) (‘Intergovernmental Fiscal Transfers by Robin Broadway and Anwar Shah’).

<sup>13</sup> Ronald Watts, ‘Origins of Cooperative and Competitive Federalism’ in Scott L. Greer ed., *Territory, Democracy and Justice Regionalism and Federalism in Western Democracies* (Macmillan 2006) 208.

<sup>14</sup> *Supra* note 12, p. xxxi.

<sup>15</sup> R. H. Neumann and T. R. Robinson, ‘The Structures and Conduct of Intergovernmental Relations’, in R. M. Bird and F. Vaillancourt eds., *Perspectives on Fiscal Federalism* (World Bank Institute 2006) 57 (‘Perspectives on Fiscal Federalism’).

<sup>16</sup> *Supra* note 12.

<sup>17</sup> R. M. Bird and F. Vaillancourt eds., *Perspectives on Fiscal Federalism* at 60, 66.

for example, the Inter-governmental Fiscal Relations Act, 1997 lays down the consultation procedures to be followed before the Budget is finalised [See Section 4.2 of this Note for more details].

Another important tool in effective inter-state consultation is the development of ‘trust-ties’ among public servants in different State Governments, establishing good working relations at the bureaucratic level.<sup>18</sup> The embodiment of this may be seen in the Canadian system, where inter-governmental coordination occurs at different levels of government with different degrees of frequency. The process of consultation with Provincial Government takes place on an ongoing basis. Permanent committees composed of federal and provincial finance officers communicate on a regular basis to settle technical issues related to fiscal transfers. These committees monitor and review the fiscal equalisation programme on a continuing basis, conducting an intensive review every five years to suggest revisions for the enactment of new national legislation for the next five-year period. Their recommendations are sent to the Continuing Committee of Officials on Fiscal and Economic Matters, made up of federal and provincial deputy ministers of finance. These Committees are given organizational and secretarial services by an inter-governmental body, the Canadian Inter-governmental Conference Secretariat. The final recommendations of this committee are then sent to the bi-annual meeting of the provincial and federal ministers of finance, which reaches final decisions. In turn, these decisions are communicated to the Prime Minister and Premiers of the Provinces in the First Ministers’ Conference, which takes place every year and consists of the Prime Minister and the Premiers. In this way, recommendations and feedback from the lowest levels of inter-governmental consultations are channelled upwards to equip the heads of the Provincial and Federal Governments in their annual discussions.<sup>19</sup>

The importance of an inter-governmental forum becomes clear from a survey of the literature on this issue. It is important to note, however, that in both theory and practice, the role of an inter-governmental forum is limited to **consultation** and **recommendation** to the Central Government on matters related to fiscal allocations. In no instance did we find such an inter-state body entrusted with the primary task of allocating financial resources to themselves.

The ISC, which has been set up under Article 263 of the Indian Constitution as a body to promote co-ordination between the Centre and States, is a suitable inter-governmental forum present under our constitutional framework which can take over the role of consultation and recommendation on matters related to fiscal allocation. The ISC currently consists of the Prime Minister, some Union Ministers and Chief Ministers of all States and its mandate is wide enough for it to take over this role. The ISC has the potential to ensure that there is meaningful State participation in fiscal allocation. While other inter-governmental forums such as the National Development Council also exist, this note focuses on measures

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<sup>18</sup> *Ibid*, at 61.

<sup>19</sup> J. M. Simmons, ‘Securing the Threads of Co-operation in the Tapestry of Intergovernmental Relations’ in J. P. Meekison et al eds., *Reconsidering the Institutions of Canadian Federalism*, available at <<http://www.queensu.ca/iigr/pub/archive/SOTF/SOTF2002.pdf>> accessed on 27 September, 2014.

to strengthen the ISC, in accordance with the Terms of Reference presented by the Fourteenth Finance Commission.

Thus, with due regard to both the relevant constitutional provisions and international experience, our conclusion in this paper is that the ISC should be strengthened in order to play an effective consultative role in the task of financial allocations, while the primary decision making process should remain in the domain of the Central Government. However, the ISC would have to be rejuvenated in order for such a role to be meaningful. The next section of this paper looks at the current status and functioning of the ISC, and suggests ways in which it can be made a more effective body.

### 3. The Inter-State Council - A Study

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#### 3.1. Constitutional position and history

The ISC is an advisory and consensus-seeking body set up under Article 263 of the Constitution with the powers to investigate, deliberate and recommend on “subjects in which some or all of the States or the Centre and one or more of the States have common interest”.<sup>20</sup> It consists of (a) the Prime Minister as the Chairperson; (b) Chief Ministers of all States; (c) Chief Ministers of Union Territories having a Legislative Assembly and Administrators of Union territories not having a Legislative Assembly; and (d) Six Ministers of Cabinet rank in the Union Council of Ministers to be nominated by the Prime Minister.<sup>21</sup> In addition, other Ministers having independent charge in the Central Government can be included as permanent invitees by the nomination of the Chairperson or for a meeting, as and when any item relating to a subject under their charge is to be discussed.<sup>22</sup> Therefore, this is a body which provides full representation to each State, Union Territory and the Centre.

The mandate of the ISC stems from Article 263, which empowers the President of India to establish an Inter-State Council if he feels it necessary and justifiable in the interest of the public. The scope of an Inter-State Council can be:

1. Inquiring into and advising upon disputes which may have arisen between States;
2. Investigating and discussing subjects in which some or all of the States or the Union and one or more of the States, have a common interest; or

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<sup>20</sup> Article 263 of the Indian Constitution, 1950; See Commission on Centre State Relations, Chapter IX (January, 1988) ('Commission on Centre State Relations') available at <<http://interstatecouncil.nic.in/Sarkaria/CHAPTERIX.pdf>> accessed on 27 September, 2014.

<sup>21</sup> Clauses 2 and 3, Inter-State Council Order, dated 28 May 1990.

<sup>22</sup> Clause 2, Inter-State Council Order, dated 28 May 1990; Inter-State Council (Amendment) Order, dated 24 December 1996.

3. Making recommendations upon any such subject and in particular, recommendations for the better co-ordination of policy and action with respect to that subject.

The Presidential order can specify the scope of such a council as well as lay down its organization and procedure.<sup>23</sup> The Constitution envisages the Inter-State Council as an arrangement to identify and investigate issues of common concern to States and give policy recommendations.<sup>24</sup>

While other inter-state bodies with specific mandates such as the National Development Council ('NDC') have been in operation since the 1950s, the ISC was only set up in 1990 based on the recommendations of the Commission on Centre-State Relations ('Sarkaria Commission') in 1988.<sup>25</sup> This was because it was felt that the issues of Centre-State cooperation were being discussed in a number of different channels in an 'ad hoc and fragmented manner', and that there was a need for a single high-level body that could make authoritative pronouncements on issues of national concern.<sup>26</sup> The need for such a body had become acute since various political parties held power in the States, and co-ordination between the Centre and State could no longer be done through party channels only.<sup>27</sup> Thus, the Sarkaria Commission observed that "there is no high-level coordinating forum other than the Inter-State Council envisaged in Article 263 of the Constitution"<sup>28</sup> and gave recommendations regarding the setting up of such a body, along with the composition and procedures to be adopted by it.

### 3.2. The mandate and functioning of the Inter-State Council

The Inter-State Council Order defines the duties of the ISC as the following:

1. Investigating and discussing such subjects, in which some or all of the States or the Union and one or more of the States have a common interest, as may be brought up before it;
2. Making recommendations upon any such subject and in particular recommendations for the better coordination of policy and action with respect to that subject; and

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<sup>23</sup> Article 263 of the Indian Constitution, 1950.

<sup>24</sup> "Inter-State Council must be a Statutory Body", *Indian Express* (3 September 2014), available at <<http://www.newindianexpress.com/editorials/Inter-State-Council-Must-be-a-Statutory-Body/2014/09/03/article2411184.ece>> accessed on 26 September, 2014.

<sup>25</sup> The Sarkaria Commission added to recommendations by previous Commissions such as the First Administrative Reforms Commission in 1966 and the Rajamannar Committee in 1969, both of which recommended the establishment of an Inter-State Council under Article 263.

<sup>26</sup> Inter-State Council, "Formations", available at <[http://interstatecouncil.nic.in/formations.html#subnav1\\_2](http://interstatecouncil.nic.in/formations.html#subnav1_2)> accessed on 26 September, 2014.

<sup>27</sup> "First Administrative Reforms Commission", available at <[http://interstatecouncil.nic.in/first\\_arc.html#subnav3\\_2](http://interstatecouncil.nic.in/first_arc.html#subnav3_2)> accessed on 26 September, 2014.

<sup>28</sup> Commission on Centre-State Relations at Chapter IX.

3. Deliberating upon such other matters of general interest to the States as may be referred by the Chairman to the ISC.<sup>29</sup>

The ISC has not been assigned the function envisaged in clause (a) of Article 263 of the Constitution, namely inquiring into and advising upon disputes which may have arisen between States.<sup>30</sup> However, the scope of its deliberative powers are broad and generic - as long as States have a common interest, it can be discussed in the ISC and recommendations can be made. Where a topic is one of 'general' rather than 'common' interest, the Chairman (i.e. the Prime Minister) may refer it to the ISC.

In addition, the ISC has framed 'Guidelines for Identifying and Selecting Issues' to be brought up before it to refine its scope. This excludes certain topics from discussion, such as topics which fall under the mandate of the NDC, the Planning Commission, the Finance Commission etc. It also excludes from discussion topics which relate to 'the discharge of any duty or special responsibility of the Union under the provisions of the Constitution or any law of Parliament' unless a majority of members, with the approval of the Chairman, feel it is important to include.<sup>31</sup> Thus, the ISC has itself narrowed the scope of its deliberations considerably, at odds with the broad mandate it received under the Presidential Order, and the reasoning that it would establish itself as the principal platform for discussion and co-ordination.

Further issues plague the functioning of the ISC. The Inter-State Council Order mandates that the ISC meets three times a year.<sup>32</sup> In practice, however, it has only met ten times since its inception in 1990, the last being in 2006.<sup>33</sup> It has not been reconstituted since the 2014 Lok Sabha elections with new Union Ministers.

The meetings of the ISC are held in-camera and its proceedings are not made public. The agenda of these meetings indicates that the chief topic of discussion in a majority of the meetings has been the recommendations of the Sarkaria Commission Report of 1988. In addition, tax matters have been discussed from time to time.<sup>34</sup>

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<sup>29</sup> Clause 4, Inter State Council Order, dated 28 May 1990.

<sup>30</sup> Report of the Commission of Centre-State Relations, Vol. II (March 2010) ('Report of the Commission of Centre-State Relations, Vol. II'). Available at <<http://interstatecouncil.nic.in/downloads/volume2.pdf>> accessed on 27 September, 2014. The Sarkaria Commission, however, had suggested that dispute resolution be included within the mandate of the ISC.

<sup>31</sup> Guidelines for Identifying and Selecting Issues, available at <[http://interstatecouncil.nic.in/guideline\\_identify\\_issues.htm](http://interstatecouncil.nic.in/guideline_identify_issues.htm)> accessed on 27 September, 2014.

<sup>32</sup> Clause 5, Inter-State Council Order, dated 28 May 1990.

<sup>33</sup> Inter-State Council, "Meetings" available at <[http://interstatecouncil.nic.in/meetings.html#subnav1\\_5](http://interstatecouncil.nic.in/meetings.html#subnav1_5)> accessed on 27 September, 2014.

<sup>34</sup> *Ibid.*

Both the Presidential Order and the Guidelines are silent on the consequences of recommendations made by the ISC. There is no positive duty imposed upon the Union or the State Governments to consider these recommendations. This led to the Eleventh Finance Commission (FC-XI) observing that the ISC, which should have been utilised for evolving national consensus on economic and other matters, has not seen ‘effective use’.<sup>35</sup>

Another oft-quoted reason for the limited role of the ISC in its present shape is its lack of functional autonomy, in the absence of a committed professional secretariat.<sup>36</sup> As of July 2014, three of the five senior-most positions in the Secretariat were vacant.<sup>37</sup> Further, the Secretariat is appointed on the choice of the Prime Minister only, with no say from the other members of the ISC.<sup>38</sup> The Secretariat, and as a consequence the ISC, is not sufficiently empowered at present to enable it to function as an effective body.

As international experience discussed above has shown, meaningful State consultation in matters of fiscal allocation requires an effective inter-governmental forum equipped with the technical and bureaucratic support. It is clear from this brief summary of the functioning of the ISC that it cannot perform this task meaningfully in its present form. The next section, therefore, looks at ways in which the ISC can be strengthened.

## 4. Recommendations to Strengthen the ISC

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Three main sets of changes may be considered to the working of the ISC, to fulfil its need for autonomy and effectiveness. First, there is a need for sufficient independent legal standing for it to function autonomously, and for its recommendations to be given due consideration. Secondly, specifically with respect to the issue of fiscal allocations, there is a need for an expert committee to be constituted under the ISC which will present independent recommendations on the financial allocations proposed by the Central Government. Thirdly, there is a need to strengthen the working of the ISC and the expert committee appointed under it with sufficient resources and the requisite infrastructure. This section elaborates on these three measures.

### 4.1. Strengthening the legal position of the ISC

As mentioned in Section 2 of this Note, studies have shown that where the number of federal units is large, as in the case of India, it becomes necessary to establish formal bodies for effective co-operation.

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<sup>35</sup> Eleventh Finance Commission Report (2000), p. 14.

<sup>36</sup> Report of the Commission of Centre-State Relations, Vol. II.

<sup>37</sup> “Deployment position and sanctioned strength of ISCS as on 18<sup>th</sup> July 2014” available at <[http://interstatecouncil.nic.in/downloads/Incumbancy\\_Position\\_ISCS.pdf](http://interstatecouncil.nic.in/downloads/Incumbancy_Position_ISCS.pdf)> accessed on 27 September, 2014.

<sup>38</sup> Clause 6, Inter-State Council Order, dated 28 May 1990.

One suggestion with respect to the functioning of the ISC which draws on this belief is to grant it greater institutional recognition by way of constitutional amendment.

The ISC is a constitutional body envisaged under Article 263 as a forum for consultation and coordination between the States and the Centre. However, it only comes in to existence through a Presidential Order. The Order determines its composition, the number of times it is supposed to meet, and its procedure. It is therefore subject to unilateral alteration by the Central Government. In addition, there are no procedures established with respect to consideration of the recommendations made by the ISC. To address this issue, the Second Commission of Centre-State Relations ('Punchhi Commission') suggested that the ISC should be given either constitutional or statutory status, giving its actions greater authority and respect.<sup>39</sup> This would ensure that the ISC "meets regularly, is endowed with sufficient resources to carry out its functions effectively, is accorded greater deference by the Centre as well as State Governments, and also commands a certain space in the domain of civil society and public deliberation".<sup>40</sup> Similarly, the FC-XI Report suggested making a constitutional amendment to Article 263 to make the ISC responsible for arriving at decisions on fiscal policies having inter-State or Centre-State ramifications as well as ensure that the ISC meets regularly and a national consensus is arrived at all important issues.<sup>41</sup>

In order to provide statutory basis for the ISC, a necessary first step is amendment of Article 263. Currently, Article 263 clearly mandates that the **President** by order may establish an Inter-State Council and define its duties, organisation and procedure. Therefore, statutory basis to the ISC cannot be established simply by Parliament, unless an amendment is introduced to Article 263 to the effect that Parliament may by law determine the composition, powers and procedures of the ISC. This can then be detailed through an act of Parliament. This will grant the same legal status to the ISC as is currently enjoyed by the Comptroller and Auditor General and the Finance Commission.

However, experience from other countries has shown that effective coordination between federal units is largely a matter of convention and practice rather than simply legislative prescription. In India, the Finance Commission also serves as a good example of this proposition. It is a constitutional body set up by a Presidential Order along with some supporting legislature, but the majority of its practice, and the acceptance of its recommendations, has developed through convention. Therefore, as an alternative to introducing a Constitutional amendment, which is a cumbersome process, Sections 4.2 and 4.3 below suggest other ways in which the objective of a stronger ISC may be achieved, by promoting the adoption

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<sup>39</sup> *Supra* note 36.

<sup>40</sup> *Ibid.*

<sup>41</sup> *Supra* note 35, p. 35.

of appropriate conventions, and making small changes to the existing Presidential Order setting up the ISC.

The other question related to the legal position of the ISC has been whether to make its recommendations binding on the Centre and the States.<sup>42</sup> The language of clauses (b) and (c) of Article 263, which lay down the scope of the role of the ISC, envisage a recommendatory role for this body, using language such as “investigating and discussing subjects...” and “making recommendations upon any such subjects”. Further, while suggesting that the ISC should be formed, the Sarkaria Commission categorically stated that it should be a recommendatory and advisory body and “it will not therefore in any way erode or encroach upon the responsibilities and powers which, under the Constitution, are the exclusive concern of the Union and the States, respectively”.<sup>43</sup> The Punchhi Commission considered this suggestion in detail in its report but ultimately stated that making the recommendations binding would go against the constitutional framework of separation of powers and was not feasible in a federal system.<sup>44</sup> Rather, it suggested that the ISC is important for consensus-building and voluntary settlement of disputes and needs to be strengthened in other aspects.<sup>45</sup> This is an important point to be considered when tackling the issue of whether the ISC can take over the task of financial allocations currently performed by the Planning Commission. Looking at the language of Article 263 outlining the scope of the ISC, it is clear that the ISC is better suited to a recommendatory role, rather than a primary role in the allocation of financial resources.

While the recommendations of the ISC should not be made binding, it may be considered to impose a positive duty upon the Centre and States to give due consideration to any such recommendations. This is elaborated on further in Section 4.2.3 below.

#### 4.2. Need for technical expertise

For the ISC to make relevant suggestions on matters such as the complex system of grant-making, its policy research and investigation capacity must be significantly strengthened. This has been a long-standing suggestion - the Sarkaria Commission, for example, suggested that the proposed Inter-State Council and its standing committee should be given the power to set up ad hoc Sub-Committees to investigate special matters.<sup>46</sup> In addition, the Punchhi Commission also recommended that the ISC could

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<sup>42</sup> “Rajamannar Committee” available at <[http://interstatecouncil.nic.in/rajamannar.html#subnav3\\_3](http://interstatecouncil.nic.in/rajamannar.html#subnav3_3)> accessed on 27 September, 2014; Amitabha Pande, “PM Narendra Modi should resurrect inter-state council to firm up his federalist intentions”, *Economic Times* (2 September 2014) available at <[http://articles.economictimes.indiatimes.com/2014-09-02/news/53480173\\_1\\_pm-narendra-modi-inter-state-council-gst](http://articles.economictimes.indiatimes.com/2014-09-02/news/53480173_1_pm-narendra-modi-inter-state-council-gst)> accessed on 28 September, 2014.

<sup>43</sup> *Supra* note 28.

<sup>44</sup> *Supra* note 36.

<sup>45</sup> *Ibid.*

<sup>46</sup> *Supra* note 43.

have expert advisory bodies or administrative tribunals with quasi-judicial authority to give recommendations to the ISC if and when needed.<sup>47</sup>

A study of international theory on fiscal transfers showed that sound systems are built around pre-articulated constitutional principles, rather than ad hoc political bargains. Such systems are more feasible and transparent. Implementation of such principles, however, rapidly becomes a complex task requiring high levels of information and technical expertise.<sup>48</sup> In response to similar challenges in Canada, South Africa and Australia, the solution has been to set up expert bodies with members who have specialised in relevant subject areas.<sup>49</sup> This was the reasoning behind the establishment of the Finance Commission as a neutral expert authority in the Constitution as well.<sup>50</sup>

From this lesson, we can establish that for the ISC to provide relevant inputs on proposed financial allocations, it would require specialised assessment of the proposals from experts who are appointed by the ISC, yet are sufficiently removed from political considerations to make an independent assessment. An Expert Committee may therefore be constituted under the ISC with a two-year term, with the mandate of providing inputs on grants that the Centre proposes to make to the States, which are currently allocated by the Planning Commission. The following sub-sections explore some options regarding the composition and qualifications of such a body, as well as suggested procedures to be followed in the formulation and consideration of recommendations by this body.

#### 4.2.1. Composition of Expert Committee

The challenge with the appointment of an Expert Committee by a body such as the ISC is to keep the numbers small enough for the Committee to function effectively, yet reflect the often disparate concerns of the various State units and the Centre. This is a challenge that has been faced in other countries as well, with varying solutions. In this sub-section, we present various options regarding the method of appointment of the Expert Committee by the ISC, based on international experience.

The Committee should ideally be a small group. One combination could be to have twelve members: six State representatives and six representatives of the Centre. Such a combination would ensure equitable participation from the States and the Centre. The chairperson of the Expert Committee, who would be a member appointed to the post by the Prime Minister, would have a casting vote in case of any ties. In addition, it may be useful to have an ex-officio member who is a senior bureaucrat from the Union

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<sup>47</sup> *Supra* note 44.

<sup>48</sup> *Supra* note 12, p. 93.

<sup>49</sup> See, for example, the composition of the Australian Commonwealth Grants Commission, the Canadian Expert Panel on Equalization and Territorial Formula Financing Website and the South African Financial and Fiscal Commission

<sup>50</sup> Constitutional Assembly Debates, 4 November 1948, available at <<http://www.indiankanoon.org/doc/1054056/>> accessed on 28 September, 2014.

Ministry of Finance, to ensure co-ordination between the expert committee's recommendations and the ministry.

To determine State representation, some form of regional grouping should be adopted for States to ensure that there is equitable geographical distribution in the membership of Expert Committee (for example, to ensure that there is always representation from the North-East). Election of members on the basis of geographical distribution is a common criterion for appointment in international bodies, especially within the United Nations. For example: in the International Court of Justice, the fifteen judges are appointed not only on the basis of the prescribed highest legal qualifications,<sup>51</sup> but also with due regard to ensuring that the judges-elect represent 'the main forms of civilization' and the 'principal legal systems of the world'.<sup>52</sup> Similarly, one of the considerations for appointment of non-permanent members to the Security Council is equitable geographical distribution.<sup>53</sup>

In India, one possible regional model to be followed is the grouping done for Zonal Councils, wherein six Zonal Councils currently exist on the basis of geography.<sup>54</sup> This could be used as a model given the advantage of familiarity of such grouping. However, an issue with using this grouping is that the groups are not equal in size, i.e. some groups have more States than others, thereby making the nomination frequency dependant on the group the State is in. Therefore, a new grouping of States may also be envisaged where each group ideally consists of the same number of States.

Once these groups are formed, the expert members can be nominated to the ISC in one of the following ways:

1. The first option would be for the ISC to collectively appoint the Expert Committee through majority voting. In this process, each State would nominate one Expert; the nominees would be grouped in accordance with the State groups; and the entire ISC would vote to elect one member from each group. In addition, the Centre would nominate ten members and the ISC would collectively elect six members from the Central list. This is similar to the process followed in the appointment of the UNESCO Executive Board.<sup>55</sup> The advantage of this approach is that the Expert

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<sup>51</sup>Article 2 of the Statute of the International Court of Justice, 1945.

<sup>52</sup> *Ibid* at Article 9; See also *Starke's International Law* 449 (11<sup>th</sup> ed., I.A. Shearer, ed., New Delhi: Oxford University Press, 1994). Under a kind of 'gentleman's agreement' applicable, the regional distribution of judges to be elected is: Africa: 3; Latin America: 2, Asia: 3, Western Europe and other countries: 5; Eastern Europe: 2.

<sup>53</sup> Article 23 of the Charter of the United Nations, 1945. See also Brian Lai and Vanessa A. Lefler, "U.N. Security Council Non-Permanent Membership: Equitable Distribution for equitable Representation?", available at <<http://myweb.uiowa.edu/bhlai/workshop/lailefler.pdf>> accessed on 28 September, 2014. At present the ten non-permanent Security Council seats are distributed according to four regional electoral groupings: Africa and Asia, Eastern Europe, Latin America and the Caribbean, and the Western European and Others group.

<sup>54</sup> Zonal Councils, "Background", available at <[http://mha.nic.in/zonal\\_council](http://mha.nic.in/zonal_council)> accessed on 28 September, 2014.

<sup>55</sup> Appendix 2, Rules of Procedure of the General Conference, UNESCO, available at <<http://unesdoc.unesco.org/images/0018/001874/187429e.pdf#page=65>> accessed on 29 September, 2014.

Committee is appointed collectively by the ISC, while the disadvantage is the potential lack of consensus if the ISC as a whole has to agree on the composition of the group.

2. The second option is to have each State group nominate one person to the Expert Committee, and the Centre to nominate six members. Within a group, members should be sent to the Committee on a rotating basis. This will ensure that each State gets representation in turn in the Expert Committee, while regional representation is also maintained. The advantage of this option is that there is less chance of conflict between the States with respect to deciding the composition of the Expert Committee, and each State would have a chance to have its appointee on the Committee at some point.

A number of different methods may be followed in the appointment of the Expert Committee. Of the two considered here, the second alternative is preferable since it allows for representation by every State in the Expert Committee by rotation.

#### 4.2.2. Qualifications of Members

There must be some minimum qualifications prescribed, in the manner of Finance Commission, for a person to be nominated and appointed on this Expert Committee. This is to ensure that the members of this group are not purely political appointees, but also have the requisite expertise and can make valuable recommendations that will not only benefit the States they represent, but the entire fiscal system. Some possible qualifications, adapting the ones required for the Finance Commission, could be:

1. having substantial experience in the fields of economics, public administration, finance, management, etc.; and
2. have special knowledge of the finances and accounts of government.<sup>56</sup>

#### 4.2.3. Procedure for the Report of the Expert Committee

In addition to appointing a qualified Expert Committee, it is important to establish procedures regarding its workings, and the implementation of its final report. The Committee should be empowered to extensively consult with Union and State Ministries, independent regulators and experts, and also receive dedicated research and technical support from a committed secretariat. Suggestions with regard to strengthening the secretariat are detailed in Section 4.3 below.

It is also very important to empower the ISC to be able to follow up on the implementation of its decisions in a structured manner, and such procedure should be provided for in the new statute governing the ISC, or in the Order setting up the ISC, as the case may be.<sup>57</sup> As observed by the Punchhi Commission, “the

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<sup>56</sup> See Section 3, The Finance Commission (Miscellaneous Provisions) Act, 1951; Section 3(3), Lokpal and Lokayuktas Act, 2013.

<sup>57</sup> See Report of the Commission of Centre-State Relations, Vol. II.

Government will be well advised to evolve an appropriate scheme to utilise the full potential of ISC in harmonising Centre-State relations which has become urgent in the changed circumstances”.<sup>58</sup>

The South African model is a useful one to study in this context. In South Africa, the Inter-governmental Fiscal Relations Act, 1997 formalises the process of consultation to be followed before the Budget is presented. It mandates that the South African Fiscal and Financial Commission make recommendations on revenue sharing and fiscal allocations to the Central Government, following which the Union Finance Minister **must** consult with the Budget Council, which consists of the Finance Ministers of the Union and the Provinces.<sup>59</sup> Timelines regarding the consultation are also prescribed in the law to ensure that the Budget Council has adequate time to consider the proposals of the Union. Enshrining of the process of consultation in law goes a long way in establishing the importance of consultation with the States in matters of fiscal allocations by way of grants.

Similarly, it could be provided under the new law governing the ISC, or by amending the Presidential Order constituting the ISC, as the case may be, that the financial allocations proposed by the Central Government are to be placed before the ISC within a certain time frame. The ISC may in turn refer it to the Expert Committee for its recommendations. These may be adopted or rejected by the ISC, and a duty placed upon the Central Government to give due regard to the ISC’s recommendations. As with the recommendations of the Finance Commission, the Finance Ministry may be obliged to present a memorandum explaining the actions it has taken with respect to the ISC’s recommendations.

#### 4.3. Other Suggestions to Strengthen the ISC

In order to increase the efficiency and competence of the Expert Committee as well as the ISC, it should be given sufficient resources and authority to carry out its functions effectively and autonomously as an independent constitutional body.<sup>60</sup> Some suggestions in this regard are as follows:

1. Staff from both the Centre and the States should be appointed to the Secretariat of the ISC, in order to inspire confidence and enhance co-ordination.<sup>61</sup> This is the approach followed in Canada where a dedicated Inter-Governmental Conference Secretariat facilitates co-ordination between provinces.
2. The meetings of the ISC should be conducted more frequently, at least thrice a year,<sup>62</sup> with detailed preparation of the agenda by the Secretariat in consultation with the parties, and

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<sup>58</sup> *Ibid.*

<sup>59</sup> Section 10(3), Inter-Governmental Fiscal Relations Act, 1997.

<sup>60</sup> *Supra* note 36.

<sup>61</sup> *Supra* note 36.

<sup>62</sup> This is also provided for in the Inter-State Standing Order, dated 28 May 1990.

position papers from all relevant parties.<sup>63</sup> Such agenda, papers etc. should be circulated prior to the meeting to ensure adequate preparation and understanding of the different viewpoints and would ultimately promote consensus building in the meetings.<sup>64</sup>

3. The infrastructure and resources of the Secretariat should be enhanced to make it more efficient.<sup>65</sup>

The ISC should also be a platform where continuing consultations between State bureaucrats and Ministers take place. An example that may be followed in this regard is the bi-annual conference of State Finance Secretaries organised by the Reserve Bank of India. These conferences are held on a voluntary basis, despite there being no statutory obligation.<sup>66</sup> Regular meetings of State officials from various levels of government can inform the working of the Expert Group and allow them to get an accurate picture of the issues faced by States in fiscal matters.

Finally, the Report of the National Commission to Review the Working of the Constitution had suggested that it was desirable for the States to be involved in deciding additional terms of reference of the Finance Commission and this could be done through the NDC discussing and endorsing such additional terms of reference which would take care of aspects of the financial relations between the Centre and the States in a comprehensive way.<sup>67</sup> It is suggested that such discussion and endorsement may be done by the ISC instead of the NDC.

#### 4.4. Relationship between the ISC and the NDC

A final point to be considered with regard to the functioning of the ISC is its relationship to the NDC, going forward. At present, the scope of the ISC is curtailed as its guidelines indicate that it will not discuss a topic that falls within the ambit of the NDC.<sup>68</sup>

The NDC was set up on 6 August 1952 by an executive order on the recommendation of the Planning Commission. It however has not been set up under Article 263 and thus its constitutional validity is not as firm as that of the ISC. Further, going strictly by the wording of Article 263, the mandate of the NDC

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<sup>63</sup> *Supra* note 36.

<sup>64</sup> *Ibid.*

<sup>65</sup> *Ibid.*

<sup>66</sup> Dr. Y.V. Reddy, “The Reserve Bank and the State Governments: Partners in Progress” (24 September 2007). Available at <[http://www.rbi.org.in/scripts/BS\\_SpeechesView.aspx?Id=355](http://www.rbi.org.in/scripts/BS_SpeechesView.aspx?Id=355)> accessed on 29 September, 2014.

<sup>67</sup> The Report of the National Commission to Review the Working of the Constitution, Volume I, Chapter 8 (31 March 2002). Available at <<http://lawmin.nic.in/ncrwc/finalreport/v1ch8.htm>> accessed on 29 September, 2014.

<sup>68</sup> Guidelines for Identifying and Selecting Issues, available at <[http://interstatecouncil.nic.in/guideline\\_identify\\_issues.htm](http://interstatecouncil.nic.in/guideline_identify_issues.htm)> accessed on 29 September, 2014.

is narrower than that of the scope envisaged for the ISC, and it essentially acts as an adjunct body to the Planning Commission.

It is unclear what the role of the NDC would be after the dismantling of the Planning Commission. It would be more efficient, and have a stronger constitutional basis, to merge the NDC with the ISC, and transfer some of the manpower and assets of the Planning Commission to the ISC Secretariat.<sup>69</sup> This would also avoid potential duplication of work.

## 5. Conclusion

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Based on the above discussion, this note concludes that the ISC should be strengthened in order to play an effective consultative role in the task of financial allocations, while the primary decision making process should remain in the domain of the Central Government. In order to strengthen it in its functioning, a number of steps can be taken including:

- a. Improving the effectiveness of ISC by establishing clear norms for consultation between the Centre and the States through the platform of the ISC;
- b. Setting up an Expert Committee with adequate regional representation and infrastructure, along with a clear procedure for making recommendations on fiscal allocation to States;
- c. Improving the bureaucratic machinery that supports the ISC; and
- d. Merging the NDC with the ISC.

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<sup>69</sup> Amitabha Pande, "PM Narendra Modi should resurrect inter-state council to firm up his federalist intentions", *Economic Times* (2 September 2014). Available at <[http://articles.economictimes.indiatimes.com/2014-09-02/news/53480173\\_1\\_pm-narendra-modi-inter-state-council-gst](http://articles.economictimes.indiatimes.com/2014-09-02/news/53480173_1_pm-narendra-modi-inter-state-council-gst)> accessed on 29 September, 2014.