

**NEW ECONOMIC POLICY AND  
INDIAN FEDERALISM**

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*The package of economic reforms initiated by the new PV Narashima Rao government, is likely to generate a strong tendency towards dispersal of power. However, whether this tendency will grow and mature, will depend upon what supportive reforms, both political and economic, are taken by the Indian State. There is need for a sort of dual federalism as well as for freeing the market from the innate centralising impulses of monopoly capital. Deregulation, decentralisation and demonopolisation should grow together within a single framework of sustainable development and accountable government.*

Although it is too early to predict the outcome of the new economic policy, this policy is likely to bring about a significant change in the country's centre-state relations. The economic reforms undertaken by the PV Narashima Rao government, it should be noted, were born primarily out of government rather than market failure, and as such, will in all probability, generate forces in the direction of pulverising and decentralising power. The aim of this paper is to analyse the implications of a major chunk of these new reforms, that is, the new industrial policy, on inter-governmental relations and to emphasise the need for re-structuring such relations, so that the reforms fructify.

In a federal setting, there is a close link between the ideological stance of a regime and the concept of 'levels' of government. The more a regime has positive orientation to being a welfare state and having regulated growth, the more is the possibility that the central level will grow powerful and some sort of hegemonic federalism will emerge.<sup>1</sup> And, the more a regime is liberal and related to the instrumental value of a market economy, the more it is likely that the inter-governmental relations will be based upon decentralised networking rather than hierarchical control.

However, two variables are significant in this connection. One is the nature of the crisis, propelling the need for a major economic policy shift. Whenever an economic crisis arises as a result of market failure as in the case of the 1929 Depression, a demand is created either from the larger public or from the ruling classes or from both, for a powerful national

government to regulate the chaotic market forces. This produces the need for a reappraisal of the existing priorities resulting in a new policy emphasizing growth-cum-welfare as in the case of the American New Deal. This has the effect of strengthening immediately the national level of government and generating later, a strong centralising tendency in the inter-governmental relations. However, in case government rather than market failure explains a crisis, a demand is invariably created for deregulation and restoration of market autonomy. And, concurrently, a hostile public reaction is generated against the centralised state control.

The second significant variable is the public image of the state and local governments. In USA, for instance, the states' proved capability in recent years to manage the distribution of limited oil and gas resources in the wake of the Arab oil embargo, their increasingly impressive record on the civil rights issue and their united response to policy challenges on international trade etc., have enhanced the status of the state governments and have established the legitimacy of the states as autonomous polities. The resultant favourable public image of the sub-national levels in American federal government, seems to have put a brake on the centralising impulses of the national government and has heralded a new dawn marked by "noncentralisation in the federal system".<sup>2</sup>

In India, the mounting economic crisis in recent years has its roots in the government's failure to regulate national economic forces. While the rise of an overgrown national government with its enormous economic power due to industrial licensing and other regulations, has nearly resulted in the strangulation of the market economy, it has at the same time led to the emergence of India's hegemonic federalism. India's federal structure was conceived by the Constitution Makers mainly in terms of cooperative parameters, notwithstanding the fact that this has a certain in-built impulse for central dominance.<sup>3</sup> However, the ideological stances of India's erstwhile political leaders on social and economic development and the strong power psychology of the national bureaucracy supported by macro political and economic forces of various types, combined together to transform the somewhat cooperative federalism into an almost wholly hegemonic federalism.

Since the ideological framework of economic development and the regulatory tools on which the government had relied for about 40 years, have failed to deliver the goods, and since, moreover, an economic crisis has now emerged, an appraisal of the government's role, its priorities and tools seems to have ensued. From this has resulted the new economic policy. As the Statement on Industrial Policy says, "The attainment of technological dynamism and international competitiveness requires that

enterprises must be enabled to swiftly respond to fast changing external conditions that have become characteristic of today's industrial world. Government policies and procedures must be geared to assisting entrepreneurs in their efforts. This can be done only if the role played by the Government were to be changed from that of only exercising control to one of providing help and guidance by making essential procedures fully transparent and by eliminating delays"(italics mine).<sup>4</sup> To do this, as the Statement further says, "industrial licensing will henceforth be abolished for all industries", except for those having overriding security, social and environmental considerations.

This is followed by policy measures directed towards refurbishing the public sector image by making the public sector enterprises "more growth-oriented and technically dynamic" and by identifying priority areas for the growth of public enterprises in the future. With regard to the use of the MRTP Act, the Statement says that "...emphasis will be on controlling and regulating monopolistic, restrictive and unfair trade practices rather than making it necessary for the monopoly houses to obtain prior approval of the Central Government for expansion, establishment of new undertakings, merger, amalgamation and takeover, and appointment of certain directors".

The principal policy objective, as the Statement emphasises, is "to unshackle the Indian industrial economy from the cobwebs of unnecessary bureaucratic control". In other words, the objective is to liberate the economic forces, especially the market from the stranglehold of the centralised red-tapism. This policy, if pursued systematically and honestly, is likely to lead towards the eventual rise of a spatially dispersed market-oriented economy where all levels of government will have important responsibilities. However, whether this tendency will grow and mature, will depend upon significant policy supports from the Indian State. And, this will ultimately depend upon whether the political leadership can mobilise the larger society to resist the designs of entrenched interests to prevent dispersal of power.

The principal reason why dysfunctional bureaucratic control has emerged, lies in the choice of a centralised model of planning, resource use and service delivery for development. Since in working this model has evolved the convergence of interests of India's national political leadership, national bureaucracy and monopoly capital, this model has operated for such a long period of 40 years or so. And, it has continued for an additional reason that the hope of public sector enterprises would transform the economy into a de-concentrative, regionally balanced one, was belied.

The deepening economic crisis as evidenced by unmanageable balance of payments difficulties on one hand, and the persistence of abysmal poverty among the masses, increasing unemployment and growing income and life style differentiation and the resulting inter-sectional tensions on the other, have cast a serious doubt about the legitimacy of India's model of development.

More important for our present purpose, is the effect of this model upon the federalising process. In this system of planning, the sub-national demands on matters of development /both regional and local, are not generally taken into account in political decision-making. This has served to breed almost continuous centre-periphery conflicts which are generally managed either through coercive fiscal-regulatory tools or through centripetal political directives or both. However, in the dispersed multi party system which seems to be emerging as an enduring political configuration and with deregulation tending towards a decentralised market economy, the federalising process is likely to change towards a sort of dual federalism. The acceptance by the Inter-State Council sub-committee of the Sarkaria Commission's recommendation that consultation with the states in the council should precede any central legislation on subjects in the concurrent list, may be perceived as a good beginning. However, several reforms in the structure of Indian federalism and on allied matters, are necessary.

Let us take an overview of India's federalising process in the context of development.<sup>5</sup> The Constitution clearly demarcates the boundaries of both the centre and states, and within their respective fields they are ordinarily supreme. The Makers believed that the states would enjoy autonomy in their spheres, especially in development matters of essentially local concern. However, India's federalising experience seems to have belied their belief.

The states have little or no autonomy to plan in their constitutionally delimited spheres. The most important source of frustration for them lies in their persistent incapacity to evolve autonomous development impulses, programmes and strategies in their legitimate spheres of action such as agriculture, health etc. The following table is illustrative of the extent of central encroachment upon state autonomy.

**Table****Percentage Division of the 6th Plan Outlays between Centre & State**

Heads of Development in State List	% of share Centre	in the 6th plan State
<b>Agriculture</b>		
Agriculture Research and Education	63.2	36.8
Animal Husbandry	46.2	36.8
<b>Industry and Minerals</b>		
Village & Small Scale	51.9	45.8
<b>Social Service</b>		
Health	33.0	59.9

*Source: Report of Sarkaria Commission*

At the level of the central government, there has been a rise of a number of powerful ministries dealing with subjects of essentially state concern, disbursing huge grants to induce the states to adopt their programmes, in the shaping of which the states have little or no role and for the implementation of which the states have to be continuously under Central control. When one includes in the Centre's vast financial and development apparatus, the Planning Commission and other such bodies impinging continuously on the states' sphere in development, one is struck by the gigantism of the whole apparatus.

There is a plethora of centrally planned and centrally sponsored development schemes which have soured the centre-state relationship, as this practice has consistently stifled the initiative and enterprise of the state governments and has made their constitutional accountability deceptive. These schemes constituted nearly 16% of all the state plan schemes in 1960-61, but their value mounted to about 54% in 1988-89.

Many years ago, the National Development Council had decided to restrict the value of such schemes to one-sixth or one-seventh of the amount

of assistance for state plans. Moreover, in 1988 an expert group set up by the centre recommended that before any new centrally-sponsored scheme is introduced, detailed discussions should be held with the State governments and their views should be given due weight in the guidelines for scheme implementation. The Sarkaria Commission also recommended that the centre's schemes should be kept minimum and decentralisation in plan formulation should be maximised.<sup>6</sup>

However, neither in terms of the value of the centrally-planned and centrally-sponsored schemes nor in terms of the guidelines framed for their implementation, has New Delhi shown any respect for the recommendations of the Sarkaria Commission and similar bodies. This has had the effect of blurring the constitutional distinction between the centre and state spheres and actually invalidates the federal theory of division of powers. More importantly, this erodes the concept of responsible government as enshrined in India's democratic, federal constitution.

Actually, the rise of centralised hegemony has its roots in New Delhi's enormous dominance in India's fiscal federalism. As a study shows, out of the total budgetary resources of the central and state governments, the Central government receives more than two-thirds of such resources, while the expenditure of Centre and State governments is almost equally divided, that is, fifty-fifty.<sup>7</sup> Thus the states' dependence upon the centre for the financing of its activities is to the extent of one-third. What is, however, alarming is that the bulk of transfers from the centre to the states is in non-statutory form. Even the Ninth Finance Commission in spite of its pronounced pro-centre bias, had to say that "It is worth noting that the proportion of shared taxes in states' revenues is lower now" than before. The decline, however, has been compensated by a rise in the share of grants, especially discretionary grants. If one recalls the proceedings of the Constituent Assembly, one notices that the Founding Fathers relied more on shared taxes and other statutory devolutions than on discretionary transfers for reducing the fiscal imbalance between the centre and the states. With a decline in stable and assured sources of revenue, that is shareable taxes, the fiscal dependence of the states upon the centre has grown over the years.

In the existing financial and planning arrangements, the new economic reforms cannot fructify. The basic question is: can a deregulated market-oriented economy blossom in a centralised federal polity? If the objective of the new reforms is to enhance competitiveness of the Indian economy and so its efficiency, then this precludes the concentration of governmental power at one level or private power in a few monopoly houses. The ethos of competition has to be enforced through economic as

well as political behaviour. And, competition "would require the maintenance of certain protected powers for the respective partners and therefore, a certain dualism in the federal system. Dualism can be maintained by constitutional rules, voluntary federal and state restraint, and competitive intergovernmental processes".<sup>78</sup> The same perceptive observer of federal trends in USA further says that dualism can "serve as accountability function by helping citizens to fix responsibility for policies, reducing the ability of federal and state officials to shift costs from one government to another, linking federal and state tax revenues more closely to policy responsibilities, and allowing federal and state officials to watchdog each other".<sup>9</sup>

What is then required for India is a new framework of federalism combining inter-level competition and cooperation. In other words, the basis of the structure should lie in what is known as dual federalism. This demands rejection of the key ideological assumption that has been underlying the working structure of Indian federalism for the last 40 years. The assumption is that the central government is competent and progressive, while the state governments are not; hence, major decisional powers and resources should converge at the national level of India's federal system of government. This assumption must go in order that competitive skills, complementary activities, and dual accountability can be combined in varying degrees in the country's federalising process.

This emphasises a compelling need for federal reforms. One such reform should be directed at strengthening the resource position of the state governments. This can take several forms. As was the case with Reagan's New Federalism, the central government in India should curtail domestic expenditure in proportion to the central budget, and the money thus saved can be used for larger devolution to the states. This is likely to introduce some new norms and attitudes conducive to the growth of an appropriate federal spirit. This will prevent the centre from continuously intervening as it does now on matters which solely concern the states in terms of both constitutional theory and democratic accountability. Similarly, this will protect against the states' current practice of approaching the centre whenever they have financial difficulties, thus leading to the greater self-reliance.

Simultaneously, efforts should be made to augment the resources of the states. The centre has always been reluctant to make optimal use of the revenue-earning potential under Article 269 for increasing the states' revenue. A tax on railway fares was levied in 1957, but was soon merged with railway fares, the states being compensated by a lumpsum payment. As a result, even though railway fares are increased from time to time, the



states have no share in it. An attempt should be made for an extensive use of taxing the powers under Article 269 for benefitting the states. Along with this an effort should be made to see what additional central taxes can be brought within the ambit of divisible taxes to ensure more assured transfers from the centre to the states. The centre, however, can give a part of its resources as discretionary grant in order to stimulate a particular activity in a state. For instance, the centre can provide assistance to a state government which has formulated an imaginative mass literacy or family planning programme.

The point I am emphasising is that an entitlement by the state governments to a somewhat fixed and certain revenue, is necessary to mitigate the present constraints on the discharge of their responsibilities in their constitutionally delimited areas. This will mark an important step in the direction of enforcing the principle of dual accountability. This step can be further strengthened by decentralising the existing unitary structure of institutional finance. In this connection, it may be profitable to probe the feasibility of adopting the US banking design under which "there is a requirement for banks to do their business within a demarcated territorial area".<sup>10</sup> This area may coincide roughly with the area of a state, preferably a major state.

However, the concept of dual federalism in a modern society does not preclude the possibility of centre-state collaboration in activities which impinge on their boundaries. One such activity is planning. In the existing system of planning, the state governments have always been made to play an essentially subordinate role. The power of the centre is so enormous that "at the planning stage agreement is reached reasonably close to the centre". There are many reasons for this. Firstly, the Planning Commission has been entirely national in its creation and orientation, and has generally been insensitive to state views. As the Sarkaria Commission said, the Planning Commission has been functioning more as a limb of the Union government rather than as a truly federal institution. Therefore, a plan is not treated as a joint enterprise involving the centre and the states as equal partners. Secondly, in the absence of an appropriately equipped staff, the planning machinery in most of the states remains undeveloped. This often hinders the formulation of both technically and qualitatively appreciative state plans. In contrast, the centre has an elaborate and well-equipped planning machinery. This seems to have given them a leverage in planning. Thirdly, centre-state consultation in planning is yet to cross the take-off stage. The National Development Council is a very weak consultative body which meets for a few days annually to legitimise the centre's claim on the constitutionally defined state fields. A review of the council's work

shows that it is by and large a vital machinery to ensure that the policy decisions of the centre are accepted by the states, notwithstanding the fact that many of its decisions directly encroach on state autonomy.

Very recently, the Inter-State Council has been set up. At the first meeting of the sub-committee of the Council the Home Minister SB Chavan said that the centre attaches the greatest importance to the strengthening of union-state relations, and he emphasised that the major issue was not change in the constitution but in the mode in which we work under it. He further said that the existing political set-up under the constitution required dialogue, consultation and a culture of accommodation.

It is difficult to say how this new institution will grow and shape the centre-state relations. However, if the temper of dialogue and consultation which the minister emphasised has to permeate the complex range of intergovernmental relations, a more comprehensive consultative machinery has to be set up. Before we consider this, a few words about the need for reorienting the planning mechanisms, can be said. It is a moot question whether the Planning Commission can continue in its present role and form. With liberalisation, its role seems to have dwindled and will continue to do so, once the necessary reforms in the Indian federal system have taken place. In the new situation, it will be difficult for the Commission to work in its present form. Either the planning body will have to be satisfied with the role of formulating and coordinating the central sectoral programmes or will have to be transformed into a new body endowed with the responsibility of planning both for the centre and the states. In case the Commission's role is perceived in terms of the first alternative, it would fit in with the logic of dual federalism. This however emphasises the need for strengthening the planning machinery of the states. This need is likely to increase once the concept of constitutional federalism is brought into the working structure of Indian federalism, and consequently, the states' role in development becomes significant. If the latter possibility is seriously taken, the Commission then has to be an independent technical body with a decentralised organisation and delinked from the present governmental structures.

However redesigned the planning mechanisms are, an important question concerns an appropriate institution building for relating the planning exercises to the political process in India's federal setting. The newly constituted Inter-State Council can serve this purpose by providing the political legitimacy for the technical work done by the planning body/bodies. However, in composition, organisation and functioning, the Council has to change and go beyond the recommendations of the Sarkaria Commission.<sup>12</sup> Although the report of the Commission, while advocating the

constitution of the Inter-State Council, said that "the spirit of cooperative federalism requires proper understanding and mutual confidence", this spirit is not present in the Inter-State Council. With a huge congregation of central ministers in this body, the weightage seems to have been given to the centre. This should be rectified in order to inspire the confidence of the states in the new institution. Some other reforms are necessary. The National Development Council can be merged into the Inter-State Council; and an independent secretariat with sufficient research inputs should be set up for the Council. For this, there has to be centre-state sharing in appointment, funding and control of the secretariat.

Even now there has not emerged an effective consultative machinery in India's federal system. In this regard, it is necessary to look beyond the frontiers of our federal polity. Canada could be our role model, as it has a very strong consultation and cooperation network. In order to formulate policies and to evaluate the overall Canadian federal experience, a Plenary Conference of the Prime Ministers of the national and provincial governments meets at least once a year. It has a secretariat and a plethora of committees which initiate special studies and work out agreements. Furthermore, there are other Plenary Conferences of the national and provincial ministers and deputy ministers, in particular areas of activity such as health, which meet many times a year. These conferences also have secretariats, committees and special studies initiated by committees, but done by outside experts. There is a cell in the Canadian Prime Minister's office whose job is to inspect the national-provincial contacts in special areas. Similar work is done at the other end by a cell in each provincial government.<sup>13</sup>

It is necessary for India to evolve this type of consultation and cooperation network. This, on one hand, is unlikely to dilute the concept of state autonomy, and will, on the other, provide for effective intergovernmental linkages in the twilight areas where the rigour of spatial demarcation is missing. In a genuine consultative machinery, there is no chain of command and obedience. It is necessary for India to evolve a machinery where the chain of decision-making and accountability is vertically delimited.

Once this sort of machinery emerges, the culture of accommodation is likely to be conspicuous in the federalising process in India. However, for this to happen, definite efforts in the direction of evolving a consensus have to be made. The Reports of the Sarkaria Commission, and the Administrative Reforms Commission, may provide the basis for consensus-building in structuring the channels of consultation and communication.

At the same time, it is necessary for the state governments to raise their image in the public eye. Maharashtra and Gujarat in the earlier years, and West Bengal and Karnataka in the mid- 1980's, made pioneering efforts in formulating new development programmes and taking the government close to the people. The outcome was an enhancement of the public image of these state governments. This enabled some of these state governments. (eg. West Bengal and Karnataka) to mobilise public opinion in support of federal reforms.<sup>14</sup> However, some of these efforts have recently suffered a setback, and a number of states such as Bihar continue to decay in terms of both growth and justice. Unless the state governments initiate new programmes of development and streamline their administrative apparatuses, no sustainable federal reforms are likely. This is because enduring public opinion about the desirability of such reforms cannot be created.

Along with structural reforms in centre-state relations, concrete efforts have to be made to bring about a dispersed economy. As is widely known, the public sector enterprises have failed to achieve the goals of promoting regional balance and resisting monopoly growth in the private sector. Besides, the huge infrastructural facilities created at public cost, have helped the growth of large-scale rather than small-scale industries.<sup>15</sup> The political consequence of the trade-off between public bureaucracy and the private management system in India's development planning, has been the rise of an industrial pattern where the centralising needs of monopoly capital have received a markedly preferential treatment. The liberation of the market from the stranglehold of the centralised public bureaucracy is a step in the right direction. Equally important is the need for freeing the market from the innate centralising impulses of monopoly capital. This calls for a deliberate public policy thrust oriented towards demonopolising the future industrial growth process in India. For this, what is needed, is an extensive mobilisation of state resources for initiating and supporting the building of a decentralised network of small industries in order to prevent a drift towards further growth of centralised monopoly capitalism.

The recent attempt at liberalisation of the economy seems to promise a new beginning. In order to carry this promise to its fulfilment, it is necessary to opt for more reforms. The overall political climate seems favourable. With the breakdown of one-party dominance there has arisen centre-state disharmony at the political level. This disharmony is likely to curb the earlier blatant centralisation and lead to building of institutions aimed at initiating a process of mutual adaptation in a spirit of 'give and take'. The recently mobilised political impulse for decentralisation, is an additional favourable factor. However, even deregulation and federal reforms are

unlikely to create a strong decentralising influence in the working of India's economy and polity, unless actions are taken to curb further growth of monopoly capital through appropriate planning and fiscal control. What is actually needed is effective use and management of resources not in a myopic sense, but from the perspective of sustainable development and accountable government.

## Notes and References

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