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Balancing Centralization with Decentralization in India's Fiscal Federalism for a Globally Integrated Economy

RUCHIRA CHATURVEDI ¹

ABSTRACT

The Constitution of India undoubtedly establishes a federal system of government, characterized by a decentralized sub-national government. The globalization of the economy indicated the necessity and efficiency of a more centralized approach of the government. Following the economic liberalization in 1992, India integrated its economy into global market, necessitating gradual modifications in the interaction model between the Centre and States. Yet, never has an attempt been made to modify the scheme of distribution of fiscal powers between the two federating units. It was only in 2016 with the Constitution (One Hundred and First Amendment) Act, 2016, that the original scheme of the distribution of fiscal powers between the federating units was modified towards a more centralized uniform system. This deviation caused concerns over the loss of fiscal autonomy by the States and posed questions of balance between the Central and State fiscal powers finding solutions in the models of interaction between the federating units.

Cooperative federalism has been suggested as a plausible solution to the maintenance of balance in the federal system as envisaged by the Constitution of India. This paper explores the true import of Cooperative federalism and analyses it as an instrument to balance centralization, a necessity for a globally integrated economy, with decentralization, a necessary element of the federal system.

The research paper is divided into three parts. The first part is dedicated to establishing the tenets of fiscal federalism in India with focus on the essence of the subnational government's autonomy. The second part explores centralization and decentralization to their varying degrees in the prescriptions of the Constitution of India. This part explores decentralization as one of the key elements of the federal system, arguing that centralization may not always be against the scheme of federalism. The third part discusses the cooperative federalism as an instrument to balance decentralization as an element of federalism with centralization as a necessity for a globally integrated economy.

Keywords: *Federal system, cooperative federalism, decentralisation, centralization, globalization*

¹ Author is a Ph.D. Scholar at Dharmashastra National Law University, Jabalpur, India.

I. TENETS OF FISCAL FEDERALISM IN INDIA

Universal Fiscal federalism is the economic dimension of political federalism. It necessitates an exploration built on the foundational principles of political federalism.

Federalism prioritizes coordination between government units, recognizing its significance for individual liberties within a shared territorial framework.² Given the inherent complexity of the concept of federalism, scholars³ acknowledge the difficulty in establishing or agreeing on a single formula that comprehensively defines its structure, and characteristics, including division of powers. Federal characteristics vary in their degree of presence across different federal systems. While extensive research has refined federalism from its classical conception into diverse theoretical models, there is an absence of a universally accepted definition of federalism.

Watts (1998)⁴ categorizes *federal political order* as a broad political arrangement characterized by a combination of shared and self-rule. In this categorization, federalism is distinguished as a descriptive theory advocating division of authority⁵ wherein federation represents one variant among other decentralized political structures such as confederations, unions, and leagues.⁶ While this perspective helps differentiate federalism from unitary governance, it does not systematically classify varying federal models. Despite definitional ambiguities, scholars agree on certain essential elements of federalism.

Historically, attempts to define federalism have taken different forms, *for instance*, in 1905, U.S. Supreme Court Justice David Brewer articulated⁷ the principles of ‘dual federalism,’ which emphasized:

1. Distinct, non-overlapping authority exercised by federal and State governments.

² The Editors of Encyclopaedia Britannica, “Federalism,” *Encyclopaedia Britannica*, June 2025. available at < <https://www.britannica.com/topic/federalism> > last seen on 18-06-2025

³ Robin Boadway and Frank Flatters, “Efficiency and Equalization Payments in a Federal System of Government: A Synthesis and Extension of Recent Results” vol. 15, issue 4 *Canadian Journal of Economics* 613 (1982); Jameson Boex and Jorge Martinez-Vazquez, *Local Government Finance Reform in Developing Countries- The Case of Tanzania* (Palgrave Macmillan, London, 2006); Wallace E. Oates, *Fiscal Federalism* (Harcourt Brace Jovanovich, New York, 1972); Roy W. Bahl and Johannes F. Linn, *Urban Public Finance in Developing Countries* (World Bank by Oxford University Press, 1992); Charles E. McLure, *Vertical Fiscal Imbalance and the Assignment of Taxing Powers in Australia* (Hoover Press, 1993); J. Rodden, “The dilemma of fiscal federalism: Grants and fiscal performance around the world” 46(3) *American Journal of Political Science* 670 (2002); Eduardo Wiesner Duran, *Fiscal federalism in Latin America-from entitlements to markets* (Inter-American Development Bank, 2003); Nirvikar Singh and T.N. Srinivasan, “Federalism and Economic Development in India: An Assessment” working Paper, *Stanford Centre for International Development* (2006).

⁴ Ronald L. Watts, “Federalism, Federal Political Systems, and Federations” *Annual Review of Political Science* 126 (1998)

⁵ *Ibid.*

⁶ Daniel J. Elazar, *Exploring Federalism* (University of Alabama Press, 1987); Ronald L. Watts, “Federalism, Federal Political Systems, and Federations” *Annual Review of Political Science* 126 (1998)

⁷ Robert A. Schapiro, “From Dualist Federalism to Interactive federalism” 56 *EMORY L.J.* 1 (2006).

2. Functional segregation of responsibilities between national and State administrations.
3. Judicial oversight in maintaining the boundaries between federal and State powers.

Similarly, the International Institute for Democracy and Electoral Assistance (IDEA)⁸ identifies four core features of federalism:

1. A constitutionally established system with multiple levels of governance.
2. Formal division of power between federated units.
3. Shared authority in common areas, governed by agreed rules.
4. Constitutionally guaranteed autonomy for federated units within specific policy areas.

Modern federal systems are characterized by the decentralization of power and constitutionally structured autonomy, yet there is an absence of consensus on a fixed formula. Across federal systems, the degree of power distribution varies, leading to diverse federal models that continue to evolve across different governance contexts. The absence of consensus on a fixed formula is believed to pose long-term challenges for academic discourse and policy formulation.⁹

As an economic dimension of federalism, fiscal federalism, encompasses two fundamental components: the distribution of fiscal powers- namely, the authority to generate and utilize revenue for public services- among different levels of government, and the corresponding fiscal responsibility for effective utilization of these resources. Constitutions worldwide adopt varied approaches to structuring fiscal relations between the central and local governments, with regulatory oversight often vested in independent fiscal institutions.¹⁰

The first critical component- distribution of fiscal powers- is fundamentally structured around the allocation of revenue sources between the Centre and the States, followed by an assessment of the role played by fiscal institutions- whose independence remains subject to scrutiny- in addressing vertical and horizontal fiscal imbalances.

The second critical component of fiscal federalism- fiscal responsibility- requires utilisation of the generated revenue by each level of government to provide public goods and services to the public, the ultimate beneficiary. Due to differing levels of responsibility, local governments tend to allocate a higher proportion of their revenue towards public service delivery, whereas

⁸ International Institute for Democracy and Electoral Assistance. Stromsburg, Stockholm, Sweden.

⁹ John Law, "How Can We Define Federalism" Vol. 5, issue 3 *Perspectives on Federalism* 89 (2013)

¹⁰ For example, recognizing income tax as a fundamental source of government revenue, the United States of America and Canada grant both the Centre and States (or provincial) authorities, the concurrent power to levy income tax. In contrast, India's income tax falls under the exclusive domain of the Centre, with revenue distribution to States determined periodically by the Finance Commission.

national-level governments typically generate more revenue but shoulder comparatively diminished service delivery responsibility. This disparity frequently leads to fiscal imbalances, which are addressed through intergovernmental grants aimed at bridging revenue gaps. Within this framework, the enforcement of hard budget constraints, as opposed to soft budget constraints, is emphasized to promote sound fiscal management across all levels of government.

II. KEY ELEMENTS OF FISCAL FEDERALISM

By applying the federalist principle to fiscal relations between tiers of government, four fundamental elements of fiscal federalism emerge:

1. Decentralization of fiscal powers through systematic allocation of revenue sources between different levels of government
2. Constitutionally mandated equilibrium in fiscal power distribution, designed to meet the requirements of a globalized economy while maintaining local fiscal autonomy.
3. Vertical and horizontal equalization, ensuring balanced economic development across jurisdictions.
4. Maximization of Community welfare, achieved through responsible fiscal governance.

These elements define fiscal federalism as a framework that enables autonomous financial decision-making while ensuring coordinated intergovernmental functioning towards socio-economic development. Despite its emphasis on decentralization, fiscal federalism remains focussed on holistic national growth, reinforcing the need for both independence in fiscal governance and coordination between governing units.

Thus, fiscal federalism seeks to enhance economic efficiency, optimize community welfare, and establish equilibrium through vertical and horizontal fiscal equalization.

The theory of fiscal federalism has developed over two generations of theory evolving from the traditional governance-oriented approach to modern market facilitating approach.¹¹ Across both the generations of fiscal federalism theory and related frameworks, *fiscal autonomy of the federating units* remains a fundamental principle. A comprehensive understanding of its significance is essential for analyzing any form of fiscal relationships within a federal structure and ensuring a balanced and effective system of governance.

¹¹ First-Generation Theory and Second-Generation Theory of Fiscal Federalism

A. Autonomy of federal entities

In addition to the two critical components of fiscal federalism, Autonomy has long been recognized as a non-negotiable aspect of federalism, serving as the basis for its conceptual development.

In the context of federalism, autonomy refers to the central government's non-interference in the designated domains of the States, allowing them to function independently in policymaking, planning, and implementation. This autonomy extends to the political, administrative and financial powers within constitutional framework.¹² Scholars¹³ argue that political autonomy without fiscal autonomy is largely illusory, as such a disparity often results in vertical fiscal imbalance.

Although autonomy is regarded as a core component of federalism,¹⁴ it is more specifically tied to territorial organization, with distinct structural characteristics.¹⁵ This suggests that 'Autonomy' is too expansive a concept to be studied as a singular element of federalism; rather, it warrants independent theoretical and practical exploration.¹⁶ The concept predates the nation-State system, originally referring to self-governing bishoprics and monasteries granted autonomy by emperors and monarchs due to their positions within the Church hierarchy. In its most fundamental sense, autonomy embodies the freedom to act independently.¹⁷ With the advent of nation-States and subsequent evolution of federalism, the concept of autonomy expanded beyond self-rule to encompass broader philosophical, sociological, juridical, and political dimensions.

In the context of federalism, autonomy is primarily understood in a political sense, encompassing self-government, self-determination, self-direction, self-reliance, and self-legislation.¹⁸ State Autonomy in a federal system denotes non-interference of the Centre in the Constitutionally designated spheres of State governance, ensuring that States retain

¹² Ranjit Singh, "Indian Federalism and the Demand for State Autonomy: The Akali Perspective" Vol. 62, No. 4 *Pakistan Horizon* 55 (2009).

¹³ O.C. Sud & Punam Kumari, "Fiscal Ambiguities between Centre and States" Volume LXXIV No.2 *The Indian Journal of Political Science* 289 (2013).

¹⁴ *for example*, Dr B. R. Ambedkar observed on the dependence of the States over the Centre in India, that "the legislative and executive authority between the Centre and States is portioned by the Constitution itself ... the States are not dependent upon the Centre therein." XI, *Constituent Assembly Debates*, 976.

¹⁵ Jaime Lluch, "Autonomism and Federalism" Vol. 42, No. 1 *Publius* 134 (2012).

¹⁶ Thomas Benedikter, *The World's Working Regional Autonomies: An Introduction And Comparative Analysis* (New Delhi; New York: Anthem, 2007). *See also* Paul Wetherly, *Marxism and The State- An Analytical Approach* 159 (Palgrave Macmillan, 2005)

¹⁷ James A. Gardner, *Interpreting State Constitutions: A Jurisprudence of Function in A Federal System* 124 (University of Chicago Press, 2005); *see also* James A. Gardner, "The Myth of State Autonomy: Federalism, Political Parties, and the National Colonization of State Politics" 29 *Journal of Law and Politics* 1 (2013).

¹⁸ Wasim A. Sofi, *Autonomy of A State in A Federation: A Special Case Study of Jammu and Kashmir* 17 (Palgrave Macmillan, 2021).

independence in policy formulation, administrative functions, and fiscal management. As such, autonomy serves as a distinguishing feature of a federal system, differentiating it from mere decentralization by ensuring that each level of government operates independently within its defined jurisdiction.¹⁹

Beyond governance structures, autonomy also pertains to structural dependence, specifically the distribution of power between the federating units. The growing discourse on federalism has a heightened awareness of the need to preserve diversity within multilingual and multicultural societies, making regional autonomy crucial. However, globalization, economic crises, and other market dynamics have necessitated the modern federal systems to favour a strong and dominant Centre.²⁰ It is commonly asserted that one of the State's primary objectives is to sustain capitalism.²¹ In this regard, autonomy plays a critical role, and its absence is often viewed as either detrimental to the capitalist interests,²² or beneficial to the State authority.²³ Carruthers (1994) argued that a State lacking autonomy is necessarily subordinate to external influences.²⁴ His analysis identifies three dimensions of autonomy: group affiliations, structural dependence, and cultural factors.

In a federal system governed by the rule of law and established according to the Constitutional principles, absolute autonomy between the two levels of government is unattainable.²⁵ Instead, autonomy exists within a structured framework, albeit limited to differing degrees depending on the specific federal arrangement. Thus, in a federal system, States can be considered autonomous if they possess a significant degree of independence in the managing their own affairs.²⁶ In analyzing the State autonomy within a federal system, two fundamental criteria must be considered:

¹⁹ James A. Gardner, "The Myth of State Autonomy: Federalism, Political Parties, and the National Colonization of State Politics" 29 *Journal of Law and Politics* 1 (2013). See also Wasim A. Sofi, *Autonomy of A State in A Federation: A Special Case Study of Jammu and Kashmir* 17 (Palgrave Macmillan, 2021).

²⁰ Bruce G. Carruthers, "When is the State Autonomous? Culture, Organization Theory, and the Political Sociology of the State" Vol. 12, No. 1 *Sociological Theory* 19 (1994).

²¹ Barry R. Weingast, "Second generation Fiscal Federalism: Implications for Decentralized Democratic Governance and Economic Development" vol. 65 issue 3, *Journal of Urban Economics* 279 (2007).

²² Redistributive Policies Promoting Socialism.

²³ Policies curtailing fundamental liberties in the interest of State security.

²⁴ Bruce G. Carruthers, "When is the State Autonomous? Culture, Organization Theory, and the Political Sociology of the State" Vol. 12 Issue 1 *Sociological Theory* 19 (1994)

²⁵ See also, Fred Block, "The Ruling Class Does Not Rule" Vol. 33 issue 6 *Socialist Revolution* 28 (1977); Paul Wetherly, *Marxism and The State- An Analytical Approach* 15 (Palgrave Macmillan, 2005); Bruce G. Carruthers, "When is the State Autonomous? Culture, Organization Theory, and the Political Sociology of the State" Vol. 12, No. 1 *Sociological Theory* 22 (1994).

²⁶ Andrew Heywood, *Key Concepts in Politics* 118 (New York: Palgrave Macmillan, 2005). See also Wasim A. Sofi, *Autonomy of A State in A Federation: A Special Case Study of Jammu and Kashmir* 17 (Palgrave Macmillan, 2021)

1. Non-interference of the Centre within the constitutionally demarcated domain of the States.
2. Self-rule, wherein States exercise substantial independence in managing their affairs.

The State may be said to possess financial autonomy, within the context of structural dependence, if its policies are free from influence by economically dominant class interest. Financial autonomy is characterized by the State's ability to act independently of external forces and maintain economic self-sufficiency. However, fiscal autonomy in federal systems is often counterbalanced by tax harmonization, whereby States relinquish some degree of fiscal autonomy in exchange for achieving uniformity in tax policy.²⁷

1. To fully comprehend intergovernmental financial relations under Fiscal federalism- including tax devolution and harmonization- following key questions need to be addressed:²⁸
2. Who is responsible for What? – indicating specific allocation of expenditure responsibilities.
3. Who levies which tax? – indicating constitutionally prescribed revenue assignment across the federal entities.
4. How are revenue and expenditure imbalances managed? - indicating institutional mechanisms to address vertical fiscal imbalance.
5. How do fiscal institutions adjust these imbalances? – indicating an assessment of institutional independence in correcting vertical and horizontal fiscal disparities.

To these questions, no universal answer exists. Each federal system, in consideration of its unique socio-economic factors, adapts the solution to fulfil its specific needs. However, the guiding principles for resolving these issues are grounded on the financial trio²⁹ of *efficiency* (for resource allocation), *equity* (for fair distribution), and *stabilization* (for economic resilience), collectively aimed at fostering sustainable economic growth.

B. Fiscal federalism in India

India, during its Constitution-making, realised severe resource crisis in the society demanding enhanced government obligations towards public welfare needs. In such economic scenario, it

²⁷ Diva Mehta & Sacchidananda Mukherjee, "Emerging Issues in GST and Procedures: An Assessment" Working paper no. 347, *NIPFP working Paper series*. (National Institute of Public Finance and Policy, 2021) available at https://www.nipfp.org.in/media/medialibrary/2021/08/WP_347_2021.pdf

²⁸ Paul Wetherly, *Marxism and The State- An Analytical Approach* 157 (Palgrave Macmillan, 2005)

²⁹ V.K. Sukumaran Nayar, "A New Approach to Indian Federalism" Vol 53 (1) *Indian Journal of Political Science*, 9 (1992).

was imperative to prevent inter-governmental competition in taxation- one of the primary sources of revenue- as such competition would not only create inconvenience for the taxpayer but also significantly reduce the efficiency and productivity of the tax system.³⁰ Thus, in the fiscal federal scheme adopted by the Constitution, the fiscal independence has been given primacy while maintaining the overarching control of the Centre over States towards the achievement of the national economic goals.

III. CENTRALIZATION AND DECENTRALIZATION IN THE PRESCRIPTIONS OF THE CONSTITUTION OF INDIA

Decentralization, recognized as a core principle of fiscal federalism, is challenged by the complexities of an increasingly globalized economy which necessitates a degree of fiscal centralization, particularly in areas that impact international market forces, trade, and commerce. From both fiscal and political perspective, federal systems are regarded as more conducive to safeguarding civil liberties when compared to unitary systems.³¹ Additionally, federal governments are often seen as instrumental in promoting economic efficiency through establishment of a unified market that facilitates the free movement of goods, services, and productive resources.³² However, the economic challenges posed by large-scale capitalist structures often necessitate a centralized fiscal federal policy response.³³ This inherent tension between decentralized fiscal autonomy and the need for centralized coordination presents a challenge in adapting federal structures to the demands of global economic integration, thereby underscoring the crucial role of independent fiscal institutions.

C. Revenue distribution between the Centre and States

Under the constitutional framework, revenue sources are broadly categorized into:

1. Tax and non-tax sources
2. Borrowings
3. Grants-in-aid

The detailed provisions governing the allocation of fiscal resources between the Centre and the States are outlined in Part XII, Chapter I of the Constitution of India.

³⁰ M.P. Jain, *Indian Constitutional Law* 690 (6th ed., LexisNexis, 2018)

³¹ Pierre-Joseph Proudhon, *The Principle of Federation (translated)* (University of Toronto Press, 1863)

³² Amaresh Bagchi, "Fifty Years of Fiscal Federalism in India: An Appraisal" *Kale Memorial Lecture* delivered at Gokhale institute of Politics & Economics, Pune on December 8, 2021. available at https://www.nipfp.org.in/media/medialibrary/2013/12/wp03_nipfp_002.pdf

³³ Harold Laski, "The Obsolescence of federalism" in D. Karmis and W. Norman (eds.) *Theories of Federalism: as Reader* 193 (Palgrave Macmillan, New York, 1939)

The Constitution differentiates between the legislative power to impose taxes and the authority to appropriate the proceeds of taxes so levied. Given this asymmetric federal structure, the fiscal powers held by the Centre and the States are not identical, reflecting a carefully designed system of financial governance. Clear distinctions exist between the legislative authority of the Centre and the States in terms of tax imposition with distinct allocation between the two through the Union List and State List in Schedule VII, ensuring mutual exclusivity without overlap in their respective powers.

The allocation of the taxing powers in India draws on the following considerations:³⁴

1. Adequate fiscal resources for the Centre, ensuring its ability to fulfil critical national functions such as defence.
2. Efficiency in tax collection, whereby either the Centre or the States levy and collect specific taxes based on administrative feasibility and effectiveness.
3. Uniformity in tax incidence, with certain tax subjects being designated under central authority to maintain consistency across territory of India.
4. Economic development considerations, ensuring that taxes closely linked to national economic policies remain under Centre's jurisdiction to avoid disruptions to broader economic growth and functioning of a unified market.

Taxation entries are not only distinctly categorized for the Centre and States but also separate from the general legislative subjects. This distinction underscores the principles that taxation must be confined to specific entries within the three legislative lists.

List I- Union List- includes subjects requiring uniformity in application, national unity, and the protection of territorial integrity, List II- State List- primarily encompasses taxation powers over subjects of local significance, aligning with the modern federal objective of preserving territorial, cultural, and linguistic diversity. List III- Concurrent List- contains fewer taxation-related entries, where Entry 35 permits only the establishment of taxation principles. This entry serves as a guidance for taxation matters but does not authorize tax levies, thereby preventing its application under Article 254. Of these, certain constitutional provisions grant the Centre a superior position in fiscal matters. *For example*, while 'Sales tax' falls within the domain of State taxation, Article 286 imposes specific limitations on States including:

1. Prohibition on taxing sales and purchases occurring outside the State's jurisdiction.

³⁴ M.P. Jain, *Indian Constitutional Law* 668 (6th ed., LexisNexis, 2018)

2. Restriction on taxing sales and purchases conducted in the course of import or export.
3. Exclusive authority of Parliament to impose taxes on inter-State trade and commerce.
4. Limitations on sales tax imposition for items declared by Parliament to be of *special importance*,³⁵ subject to prescribed restrictions.

These constraints reflect the inherent territorial limitations in India's fiscal federal structure. In *M/s Sheen Golden Jewel (India) Pvt. Ltd. v. State Tax Officer*,³⁶ the Court affirmed that fiscal authority constitutionally delineated between the Centre and the States, ensuring legislative competence does not overlap between their respective jurisdictions.

The legislative authority to impose taxes is distinct from the power to appropriate tax proceeds, consequently necessitating that the taxation-related legislative power must be interpreted with precision to uphold this separation. If a specific taxation entry is designated within a particular legislative list, it is inherently excluded from the scope of other legislative lists.³⁷

The appropriation of tax proceeds is governed by constitutional provisions³⁸ separate from the taxation entries in the legislative lists.

The original scheme of distribution of taxation powers under the Constitution aims to maintain a clear separation between the fiscal authority of the Centre and States. The scheme is especially meritorious in minimizing the possible conflict due to overlapping taxation jurisdictions between the Centre and the States and avoiding the operation of tax legislation within a concurrent sphere. The residuary taxation power remains exclusively with the Centre. The introduction of the Goods and Services Tax- a comprehensive indirect tax- has constitutionally modified the scheme where the Centre and the State now simultaneously possess the authority to levy tax on the same entry.

The Constitution of India is widely recognized for its strong centralizing tendencies.³⁹ Consequently, the question of State fiscal autonomy within the Constitutional framework requires examination to determine whether it exists without inherent contradictions. While the Constitution does not explicitly recognize State fiscal rights, it does affirm linguistic and

³⁵ Parliament has declared goods like sugar, tobacco, silk, cotton, and woollen fabrics as goods of special importance via Additional Duties of Excise (Goods of Special Importance) Act, 1957.

³⁶ *M/s Sheen Golden Jewel (India) Pvt. Ltd. v. State Tax Officer*. (Kerala HC) WA No. 747 of 2019.

³⁷ *Mineral Area Development Authority & Anr. v. Steel Authority of India & Anr.* (2024) 10 SCC 1 at p.11

³⁸ Constitution of India, Articles 277, 280.

³⁹ IX, *Constituent Assembly Debates*

cultural autonomy of the States, ensuring national and economic cohesion.⁴⁰

The Seventh Schedule of the Constitution distinctly allocates the legislative and executive powers of between the Centre and the States, thereby safeguarding against undue intervention in each other's spheres of governance. Within this federal framework, the notion of State autonomy refers to substantive and constitutionally conferred powers that are capable of being independently exercised by the State governments. Authentic autonomy, in this context, encompasses the capacity of States to design and implement development strategies attuned to their regional priorities and resource capacities- so long as such initiative align with national interest and contribute constructively to the broader developmental trajectory of the country. However, the constitutional architecture simultaneously endows the Centre with preeminent and supervisory role, through an expanded jurisdictional scope, overarching financial control, and residuary powers. This structural arrangement consequently perpetuates an systemic reliance of the States on central resources.

Despite this centralizing framework, efforts have been made to safeguard the fiscal autonomy of the States within their prescribed domain. The Supreme Court, in *Satpal & Co. v. Lt. Governor of Delhi*,⁴¹ underscored Parliament's residuary taxing power in the context of federalism, asserting that some legislative subjects may not explicitly fit within List I or List III but superficially appear under List II. The *doctrine of pith and substance* must be applied to accurately to accurately determine whether a matter falls within a State's jurisdiction. If not, Parliament retains the authority to legislate under its residuary power in Entry 97 of List I. Conversely, in *International Tourist Corporation v. State of Haryana*,⁴² the Supreme Court cautioned against an expansive interpretation of Parliament's residuary taxing power, which could unjustly limit the fiscal autonomy of State legislatures. Before Parliament's exclusive competence to levy taxes is established under residuary powers, the legislative incapacity of the States must first be conclusively demonstrated. Similarly, in *Jindal Stainless Steel Ltd. v. State of Haryana*,⁴³ judicial scrutiny clarified the scope of State Autonomy within fiscal federalism, affirming that constitutional provisions are designed to uphold extensive legislative and executive authority for the States, ensuring their autonomy and sovereignty within their respective domains of governance.⁴⁴

Effective fiscal federalism and decentralization are contingent on institutionalized fiscal

⁴⁰ Tasweef A. Malik, "Enlarged State Autonomy: A Possible Solution to Indian Federal System" Vol. 18 *Webology* 3030 (2021). See also IX, *Constituent Assembly Debates*

⁴¹ AIR 1979 SC 1950

⁴² (1981) 2 SCC 318

⁴³ (2017) 12 SCC 1

⁴⁴ *Jindal Stainless Steel Ltd. v. State of Haryana* (2017) 12 SCC 1 para 87

discipline, which should not be misconstrued as a licence for fiscal imprudence.⁴⁵ Friedrich von Hayek (1939)⁴⁶ posited that decentralization may enhance governmental fiscal responsibility; however, this outcome is conditional upon the existence of robust accountability frameworks. Accordingly, States must operate under hard budget constraints, with bailouts treated as exceptional interventions rather than routine instruments.

In alignment with global fiscal best practices, many federal nations have adopted legislative frameworks aimed at curbing fiscal deficits and reinforcing fiscal prudence among constituent units. Reflecting this trend, India enacted the Fiscal Responsibility and Budget Management Act, 2003, which institutionalizes the Central Government's commitment to long-term macroeconomic stability and intergenerational equity in fiscal governance. The legislation facilitates the removal of fiscal impediments to effective monetary policy implementation and enables strategic debt management consistent with the goal of fiscal sustainability.

Unlike other federal systems, India's taxation framework prevents inter-State and Centre-State competition in tax collection, thereby avoiding jurisdictional conflicts. While the fiscal federal scheme is in alignment with India's federal model exhibiting tilt towards the Centre and apprehension of centralization, the constitutional framework of the fiscal distribution of powers and the judiciary's interpretive approach thereon preserves the decentralized scheme of the fiscal federal structure. This approach has been widely appreciated,⁴⁷ particularly given India's historically underdeveloped economy and the limited tax-paying capacity of its population.

IV. COOPERATIVE FEDERALISM AS AN INSTRUMENT TO BALANCE DECENTRALIZATION WITH CENTRALIZATION

Federal systems exhibit variation based on three key factors: the degree of centralization, the extent of autonomy granted to federal units, and the nature of interaction between the Centre and the States. While the degree of centralization and the fiscal autonomy are decipherable from the Constitutional scheme of fiscal federal model, the interaction may take different forms. Interaction between the Centre and the States is fundamentally shaped by the attitude and temperament each unit adopts in pursuit of governmental and national objectives. Minimal coordination between two sovereign entities is commonly referred to as coordinate

⁴⁵ Jonathan A. Rodden. *Hamilton's Paradox: The Promise and Peril of Fiscal Federalism*, 3 (Cambridge University Press, 2005)

⁴⁶ Friedrich von Hayek, "The Economic Conditions of Inter-State Federalism." 5(2) *New Commonwealth Quarterly* 131 (1939) Reprinted in Friedrich von Hayek, *Individualism and Economic Order* 255 (University of Chicago Press, Chicago, 1948)

⁴⁷ M.P. Jain, *Indian Constitutional Law* 668 (6th ed., LexisNexis, 2018)

or dual federalism; competitive dynamics between the two sovereign entities is termed as competitive federalism; and a collaborative interaction between the two entities is known as cooperative federalism.

Cooperative federalism is characterized by coordination and collaboration, wherein the federal constitution establishes principles for collaboration among federal units. As Corwin (1978)⁴⁸ articulates, this model enables governmental entities to function in a mutually complementary reinforcing manner, appearing as a unified governmental framework in pursuit of policy objectives. Within this paradigm, both Centre and States operate in close synergy, reflecting their interdependence. Paras Diwan (1979)⁴⁹ further observes that cooperative federalism emerges when two tiers of government are not positioned in opposition but instead collaborate to facilitate effective governance. The extent of cooperation varies, producing distinct variations of this federal model.

The intensity of cooperation within a federal structure is assessed primarily through two mechanisms: development initiatives predominantly funded by the federal government and their administration, which is largely managed by the regional authorities.⁵⁰ Judicial interpretations⁵¹ frequently underscore the necessity of cooperative federalism to fortify Centre-State relations for improved governance outcomes as per the tenets of good governance. *For instance*, in *Mohit minerals*,⁵² the Supreme Court of India explicitly affirmed cooperative federalism as foundational to Centre-State interactions, albeit without an extensive exploration of its implications.

Notably, rather than prescribing a fixed theoretical model, constitutions generally refrain from defining a singular mode of federal interaction. Instead, federal units dynamically determine their engagement based on evolving economic imperatives, while the judiciary serves as an arbitrator fostering harmony among these units to facilitate economic growth and development. However, cooperative federalism may inadvertently erode the constitutionally designated jurisdictions of the Centre and the States, often leading to diminished autonomy for the States as they accommodate federal cooperation. Consequently, the judiciary assumes a dual responsibility: not only as a facilitator of coordination but also as a custodian of federal principles. Judicial guidance must thus adhere to an interpretative framework that respects

⁴⁸ Edward s. Corwin, *What the Constitution means today* (Princeton University Press, 1978).

⁴⁹ Paras diwan, *Indian Constitutional Law* (Sterling Publishers Pvt. Ltd., 1979).

⁵⁰ Anusha Pal, "Analysis on 'Cooperative and Competitive Federalism' in India" Vol. II (2) *Indian Journal of Integrated Research in Law*. 271, 279 (2022)

⁵¹ S. Mukherjee and S. Ramaswamy, *Political Science Annual 1997* 31 (Deep & Deep Publications, New Delhi, 1998).

⁵² *Union Of India vs M/S Mohit Minerals Pvt. Ltd.* 2022 SCC OnLine SC 657

federal boundaries, ensuring that State legislatures retain their legislative authority, while simultaneously safeguarding the Centre's supremacy to enable national development.⁵³

Cooperative federalism posits a partnership between national and regional governments in the exercise of governmental authority,⁵⁴ ostensibly fostering holistic economic advancement. Nevertheless, this approach may inadvertently exacerbate disparities among States. *For instance*, following establishment of NITI Aayog, India formally embraced cooperative federalism as a conduit for economic development. However, the absence of a comprehensive long-term strategy has led to uneven distribution of gains, benefitting select regions and demographics, thereby exacerbating pre-existing socioeconomic inequities such as low-income levels and persistent unemployment.⁵⁵

V. CONCLUSION

Despite economic challenges, India's fiscal federal framework has demonstrated considerable resilience and adaptability towards the changing demands of the global economy. Towards balancing decentralization with centralization, the model of Cooperative interaction between the Centre and the States has facilitated a more active role for States towards national development. However, this has come at the cost of perceptible erosion of State fiscal autonomy. While concerns persist that this centralization could be vulnerable to politicization, there is limited empirical evidence to substantiate such claims.

India's fiscal federalism may be best described as a hybrid system, marked by cooperative intergovernmental engagement yet reflective of an asymmetrical power and responsibility structure. the relationship between the Centre and the States can be likened to that of an elder and younger sibling- wherein the Centre charts the national development agenda, and the States contribute through aligned efforts, often relying on the Centre for fiscal support. In turn, the Centre bears responsibility for maintaining the overall fiscal health, while ensuring States continue progressing toward sound and responsible fiscal practices. Thus, while on theoretical precepts, the tenets of cooperative federalism are yet to be definitively declared and located, the analogous perception of the cooperative federalism in the Indian scheme of fiscal federalism has already made its mark.

⁵³ *Jindal Stainless Ltd. v. State of Haryana*. (2017) 12 SCC 1.

⁵⁴ Tulika Chakraborty, "Cooperative Federalism through the experience of India" in Prof. Saroj Rani Verma (ed.) *Cooperative Federalism in India: Myth or Reality* (Deep and Deep Publications, 2012)

⁵⁵ Editorial, "In praise of a more Free Market India" *Economic Times*, August 15, 2024. available at <https://economictimes.indiatimes.com/opinion/et-editorial/in-praise-of-a-more-free-market-india/articleshow/112532278.cms>