



134/2022/Mfin

22.07.2022

Dear Smt. Nirmala Sitharamanji,

Sub: Regarding Borrowing consent Under Article 293(3) of the Indian Constitution

I am writing this letter to seek your kind, urgent intervention in an issue that threatens to seriously compromise the federal-state financial arrangements envisaged in the Constitution of India.

1. This letter is addressed to you in the backdrop of the grave financial crisis that the State Government is facing currently. The financial health of the state has been seriously affected by a reduction in the revenue deficit grant to the tune of around Rs 7000 crore this year and loss due to stoppage of GST compensation of around Rs 12000 crore. In addition, the Ministry of Finance has arbitrarily, in the name of off-budget borrowing, made a reduction of approximately Rs.4000 crores in the net borrowing limits of the State. In all the State Government will have to contend with a reduction of Rs 23000 crore in the financial resources available to it for financing the budget in the current financial year. This poses a serious threat to the government in sustaining spending on welfare schemes for the poor, including housing, education and health among others. Unless the realities faced by the State, particularly given the fact that the State is struggling

to emerge from the economic debilitation wrought by the Covid pandemic, are recognised by the Union Government, the safety of the socio-economic security system that the state has worked so hard to build over the last several decades will be in jeopardy.

2. The composition of the financial liabilities of State Governments has changed significantly in the last 25 years. The share of loans and advances from the Centre has declined from over 15.8% of all State liabilities in 2005 to 3.0% in 2020. Kerala is no exception to this trend. The outstanding loans and advances from the Centre to Kerala State as a percentage of Kerala State's total liabilities have reduced from 12.4% in 2005 to 3.3% in 2020. This trend towards greater fiscal decentralisation in India was fundamentally on account of the recommendation of the Twelfth Finance Commission for disintermediation of the Central Government from raising public debt by State Governments. The rationale for this recommendation was that States would now rely on market borrowings to finance their expenditure and would, accordingly, be subject to the discipline of the financial markets. States that borrowed unsustainably would face higher interest rates, while fiscally prudent States would be able to borrow at cheaper rates.
3. The Finance Commissions constituted by the Government of India under Article 280 of the Constitution, once in five years play an integral role in regulating sub-national borrowings, as evident from the recommendations of the Twelfth Finance Commission in 2004-05 for the disintermediation of the Central Government from the raising of public debt by State Governments.

Over the years, Finance Commissions have been recommending targets for States' fiscal deficit and outstanding debt, the basis on which the Central Government fixes the Net Borrowing Ceiling of States for a particular financial year.

4. However, over the last five years, some of the actions of the Union Ministry of Finance while fixing the State's net borrowing ceilings has raised some grave concerns for the State Governments. It is pointed out that under the declared objective of fixing the net borrowing ceiling, Article 293(3) of the Constitution is being used to vitiate the State's independence and make systematic inroads into the financial autonomy of State Governments, enshrined in our Constitution.
5. The Constitution defines the scope of executive power of the Union and the State Governments. By virtue of the provisions of Articles 73 and 162, the executive power extends to all matters concerning which the Parliament and the State Legislature have the power to make laws. This executive power is broad. By the Entries 35 and 43 in Lists I and II of the 7th Schedule, the executive power of the Union and the States shall extend to the public debts. It appears that to put the matter beyond any shadow of doubt and enforce a kind of fiscal discipline, the framers of the Constitution made specific provisions in respect of 'borrowing' by the State and the Union Governments. These are contained in Chapter II of Part XII of the Constitution in Articles 292 and 293 of the Constitution. Article 292 deals with the executive power of borrowing upon the security of the Consolidated Fund of India, and Parliament, by law, has the power to regulate the limit. Article 293(1) deals with the executive power of a

State to borrow within the territory of India upon the security of the Consolidated Fund of the State, and the Legislature of such State by law is empowered to fix the limit. Article 293 (2) enables the Government of India to make loans to any State so long as any limits set under Article 292 are not exceeded.

6. Article 293(3) of the Constitution fetters the state's power to raise loans. Under this provision, if there is still any part of a loan made to the State by the Government of India or in respect of which the Government of India has given a guarantee, State is forbidden from raising any loan without the consent of the Union Government. The words 'any loan' in this chapter must be read in light of the accepted canons of Interpretation of Statutes. In *Chandra Mohan v. State of U.P.* AIR 1966 SC 1987, a five-judge Bench of the Supreme Court held that the words "*service of the Union or the State*" do not mean any other service of the Union or the State except the *Judicial Service* as defined in Article 236(b) of the Constitution. Applying the Latin maxim "*ejusdem generis*", which means "of the same kind or nature", which is an accepted principle of statutory construction, the words *any loan* appearing in Article 293(3) similarly must be read as any loan advanced by the Central Government. Any different construction to the words *any loan* would cut at the root of our country's federal nature, one of the salutary edifices on which our founding fathers of the constitution has rested the idea of India. In *S.R. Bommai Vs Union of India (1994)* 3 SCC Page 1, the Hon'ble Supreme Court held that federalism is part of the basic structure of the Constitution and no Act should impinge on this federal

character. It is therefore clear that any interpretation of Article 293 that overrides the Constitution's federal character would be impermissible. Further, the liabilities of other instrumentalities of the State Government, like Statutory bodies and companies, do not come within the definition of State debt as envisaged in this Chapter. The definition of 'State' in Article 12 only applies to the provisions of Part III of the Constitution. 'State' as defined in Article 293 of the Constitution will have to be construed as a reference to the States as defined under Article 1(2) of the Constitution read with the 1st Schedule to the Constitution. The Hon'ble Supreme Court in *State of Bihar v. Union of India & Anr* [(1970) 1 SCC 67] and *Tashi Delek Gaming Solutions Ltd & Anr v. State of Karnataka & Ors* has held that the enlarged definition of 'State' as defined under Article 12 of the Constitution would not apply to other parts of the Constitution. The move to combine the debts of legal entities owned by the State and the general debt of the State Government is contrary to the provisions of the Constitution. It would imperil the borrowing powers of the States and jeopardise the development plans it seeks to achieve through its various agencies.

7. To further explain, the requirement that a State must obtain consent under clause (3) of Article 293 of the Constitution of India is applicable only when a State is **either indebted to the Centre, or when repayment of a loan taken by the State which the Centre has guaranteed remains outstanding.** This implies that the purpose of this provision in the Constitution is to protect the rights of the Centre in its capacity as a creditor. Clearly, therefore, the conditions under

clause (4) of Article 293 must necessarily be directly related to the specific loan for which the Government of India issues consent under clause (3) of Article 293. In other words, using Article 293(3) and (4) of the Constitution to regulate and oversee the financial management of the State Governments and their agencies is far beyond what is contemplated in the Constitution.

Controlling the management of the Public Account of the States through actions *ultra vires* Article 293(3)

8. For over seven decades after the Constitution was enacted, successive Union Governments have always adhered to the constitutional provisions respecting the financial powers vested with the State Governments to manage their affairs. In August 2017, Article 293 (3) was wrongly and unconstitutionally administered to significantly constrain the financial freedom of State Governments. That year *vide* letter No. 40(6) PF-I/2009-Vol III dated 28th August 2017; the Government of India decided to effectively include the balances in the Public Account of the State while reckoning the Net Borrowing Ceiling of the State Government.
9. Article 293(3) can only be legitimately used for imposing conditions related to a request for borrowing of a State Government. This cannot be used to control or administer the borrowing of the State Government. Under the Constitution, these are matters that exclusively remain in the domain of the State Government. Thus clearly, even if for argument's sake, conditions under Article 293(3) were to be made generalisable over the overall annual borrowing programme of

States, this could at most apply to the State's share of Open Market Borrowings and the borrowings from Central PSUs and Financial Institutions like LIC, NABARD etc., which are regulated administratively by the Union Government or are a necessary part of the monetary policy of the Union Government. It is not difficult to see that such conditions cannot go beyond and be used to control and regulate the exercise of the State's financial powers itself.

10. Furthermore, the Public Account of the State is a constitutional provision in Article 266(2) where all transactions of the State Government other than those credited to or debited from the Consolidated Fund of the State. Article 283(2) confers on the States the powers of regulating its Public Account under law made by the Legislature of the State. The Public Account of the State reflects its internal financial transactions where constitutionally the State plays the role of a banker to itself. But, without a valid legal or financial basis, Government of India, by deciding to arbitrarily exclude amounts in the Public Account in assigning the net borrowing ceiling, has attempted to make serious inroads into the constitutional financial powers of the State Governments while at the same time seriously impairing the ability of the State to manage its liquidity from time to time.

Constitutionally untenable attempt to control financial operations of Government Agencies of the States through incorrect interpretation of Article 293(3) & 293(4)

11. It is pointed out that this year, unfortunately, the above approach of the Finance Ministry in incrementally making inroads into the State's powers enshrined in

the Constitution has gone further. The Ministry of Finance has now stipulated that along with balances maintained in the Public Account of a State Government, all borrowings of State Government entities receiving budgetary support from the State Budget will also be taken into consideration while setting the borrowing limits of the State Government. Vide Letter no. 40(2) PF-S/2022-23 dated 31.03.2022 of the Department of Expenditure containing instructions on the Net Borrowing Ceiling for the financial year 2022-23 it was stipulated that Borrowings by State Public Sector companies/corporations, Special purpose vehicles (SPVs) and other equivalent instruments, where principal and/or interest are to be serviced out of the State Budgets and/or by assignment of taxes/cess or any other State's revenue, **shall be considered as Borrowings made by the State itself for the purpose of issuing the consent under Article 293(3) of the Constitution of India.**

12. Presumably, an oft-repeated argument is that the Comptroller and Auditor General (C&AG) of India have classified borrowings of agencies of States Governments as off-budgetary borrowings. This is then touted as the basis for the current use of Article 293(3), as seen in the letter of the Ministry of Expenditure cited above. While the State Government has consistently maintained that such classification is erroneous, suffice it to say, the powers of the C&AG extends only to matters related to accounting and auditing of public money and not to the interpretation of the provisions that regulate the financial powers of the Union and the States under the Constitution. This solely falls

within the domain of the Judiciary of the country in light of the principle of separation of powers enshrined in the Constitution

13. The Union Government and the State Governments have hundreds of companies and statutory bodies established by them. These agencies help the Governments, Union and States to carry out their respective development plans. Under the Union Government, several such institutions receive budgetary support through the Union Budget either as 'grants' or as 'investments'. These institutions further tap resources extensively from the financial markets through their own borrowings. These borrowings help significantly in moving the development agenda of the country forward. Leveraging the markets through such mechanisms is now considered the cornerstone of modern financial management and is a practice that all countries resort to. While the letter of the Department of Expenditure, cited above attempts to impose restrictions on the States, the Union Government itself does not impose any such limits on its own borrowings by taking into account the borrowings of the agencies set up by it. Given this, the prescription that the borrowing of State Government Agencies will be reckoned to determine how State Government agencies should access the financial and money markets of the country becomes discriminatory, illogical and unfair - apart from the fact that it clearly violates the Constitution.

14. To reiterate, the scope of Article 293(3) and (4) are limited to the State as defined under Article I (1) of the Constitution. It cannot be extended to include the debt of Government Agencies, including Companies and Statutory Bodies, regardless

of whether the Legislature of the State in its wisdom decides to finance them by way of grant or assignment of taxes and other revenues through its Budget.

15. Over the eight decades of independence, a very robust federal financial framework has evolved in the country. The Union Government has in place the Fiscal Responsibility and Budget Management Act, 2003 (Act No. 39 of 2003) enacted by Parliament. Based on this, the Union regulates its financial affairs. All-State Governments have their own version of the Fiscal Responsibility framework. The State Legislature of Kerala enacted the Kerala Fiscal Responsibility Act, 2003 Act 29 of 2003. The Legislature also enacted the Kerala Ceiling on Government Guarantees Act, 2003 Act 30 of 2003. Using Article 293(3) and (4) wrongly to drive the fiscal management of the States would seriously impinge on the federal-state financial architecture and would evidently be *ultra vires* the Constitution. Furthermore, the executive power of the Union and States is coextensive with the legislative power. Consequently, the Parliament having no legislative power vis-à-vis Article 293, no executive power could be exercised by the Union Government under those provisions.

16. As the Twelfth Finance Commission points out, any inefficiency or lack of prudence shown by the State in its fiscal management would be evaluated and assessed by the financial markets themselves. The borrowings of States rated higher in terms of their fiscal management would naturally carry a lower risk premium in the market, while others would have to pay the price of a higher risk premium. It is certainly not for the Union Government, through a

constitutionally wrong and misplaced application of Article 293(3) and (4), to make any inroad into the State's financial powers enshrined in the Constitution.

17. Yet another aspect is equally disturbing. Under the federal-state financial architecture in the Constitution, the well-established constitutional structure for making recommendations is the Finance Commission. None of the previous fourteen Finance Commissions have made any such recommendation that could serve as the basis for the above decision of the Department of Expenditure.

18. Furthermore, the Terms of Reference of the Fifteenth Finance Commission had specifically provided that, while making its recommendations, the Commission shall have regard, among other considerations to the conditions that Government of India may impose on the States while providing consent under Article 293(3) of the Constitution. Despite this specific mandate being given to the Fifteenth Finance Commission, when the Commission recommended the borrowing limits of States for FY 2022-23 and FY 2023-24 at 3.5% and 3%, respectively, no recommendations/ comments were made by the Commission on any conditions that the Union Government may impose. The Fifteenth Finance Commission was mindful of the off-budget borrowings of the State and Centre while allowing the limits and had discussed this subject extensively with the Finance Departments of the various State Governments.

19. To conclude, for your kind consideration, it would be wrong to interpretatively and selectively use Article 293(3) to undermine the federal character of the Constitution. Going beyond what is strictly required under the provision to

protect the Central Government's rights as a creditor would amount to an overreach on the part of the Government of India. Given that firstly by virtue of the provisions of Articles 73 and 162, the executive power extends to all matters with respect to which the Parliament and the State Legislature have the power to make laws and that this executive power is broad, and secondly, by virtue of the Entries 35 and 43 in Lists I and II of the VII Schedule, the executive power of the Union and the States shall even extend to the public debts, any conditions imposed by Centre on States beyond the narrow scope permissible for clauses (3) and (4) of Article 293, would necessarily be untenable and seriously hits at the basic and fundamental architecture of the Constitution that governs the public financial management of the country.

20. Hence, I request your kind self to immediately intervene in the matter and issue instructions to restore the *status quo ante* to the position that prevailed before August 2017 and exclude (1) all balances in the Public Account of the State and (2) the borrowings of State Government entities in determining the net borrowing ceiling of the State Governments in accordance with Article 293(3) and 293(4) of the Constitution.

With Warm Regards,

Yours sincerely


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