PRESERVING FISCAL AUTONOMY IN THE INDIAN SOCIAL POLICY LANDSCAPE: ADDRESSING CENTRALIZATION AND INTER-GOVERNMENTAL STRUCTURES

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Abstract

This article explores the challenges posed by centralization in the social policy landscape and its impact on fiscal federalism. The proliferated use of Centrally Sponsored Schemes (CSS) has taken up a significant portion of the Indian social policy landscape; this has effectively allowed the central government to frame policy on matters in the State List. This has had considerable reverberations on the state's fiscal capacity as these schemes are co-funded. Fiscal autonomy is crucial for state governments as it allows them to design and implement social policies that are responsive to local needs and priorities, which as research show, are more effective in delivering policy outcomes comparing to CSS. Drawing on various studies on the workings of CSS, the article points out certain structural elements that hinder the effective working of these policies. Moreover, it is argued that the uniform application of a top-down scheme in a country like India is a sub-optimal policy solution to India's social problems. This is fundamentally because Indian states are extremely divergent as the data on health, education and economy shows; this implies that every state has different policy requirements and one single scheme framed for the entire nation by the Central Government cannot possibly accommodate the unique challenges and specific needs of all the states. Examining various international examples, the article argues for altering inter-governmental structures for creating a space for the contestation and negotiation of top-down and bottom-up policy priorities; where bottom-up inputs complement top-down planning. The Article suggests that, as successfully done by various countries, this can be achieved by introducing bilateral agreements or by creating an inter-governmental forum. Such a mechanism can strike a balance between prioritising national goals and mainlining sub-national autonomy in policymaking for optimal outcomes.

Keywords: Fiscal federalism, fiscal autonomy, centrally sponsored schemes, social policy, public policy.

Introduction

Article 1 of the Indian Constitution defines India as a 'union of states' and as a federal nation, India comprises of diverse states with varying socio-economic needs and priorities. Maintaining a balance between central control and state autonomy is essential for fostering equitable development and effective governance. Fiscal federalism plays a crucial role in shaping the governance and policy landscape of a country. The distribution of fiscal powers and decision-making authority between the central government and subnational governments has significant implications for the effectiveness, responsiveness, and inclusivity of social policies

Fiscal autonomy is a critical issue in modern governance as it concerned with ability of a state to generate and manage its own revenue, without undue interference. This autonomy is essential for states to effectively address the unique needs and challenges of their citizens, and to promote economic growth and development. However, there are imbalances on a vertical and horizontal level that has strong implication on state fiscal autonomy which undermines accountability, erode the principles of federalism, and hinder effective governance and equitable development.

One such mechanism that has serious implications for the fiscal autonomy of states are the Centrally Sponsored Schemes (CSS). These schemes are made by the central government, and the state governments execute them in their states; they are financially supported by both the central and state governments. While these schemes may provide additional resources to states, they also impose certain restrictions and create limitations on their fiscal autonomy.

Centrally sponsored schemes take up a big chunk of the policy landscape; this top-down uniform application of social policy has serious implications for the effective delivery and standard of social policy in the country. This article aims to contribute to the ongoing discourse on achieving an equitable and responsive social policy framework that truly reflects the diverse needs of a nation's citizens.

Constitutional framework

Article 280 of the Constitution of India provides for the constitution of a finance commission every five years to frame directions regarding the allocation of the entirety of taxes between the union and the states (Vertical devolution) and also among states (Horizontal devolution)

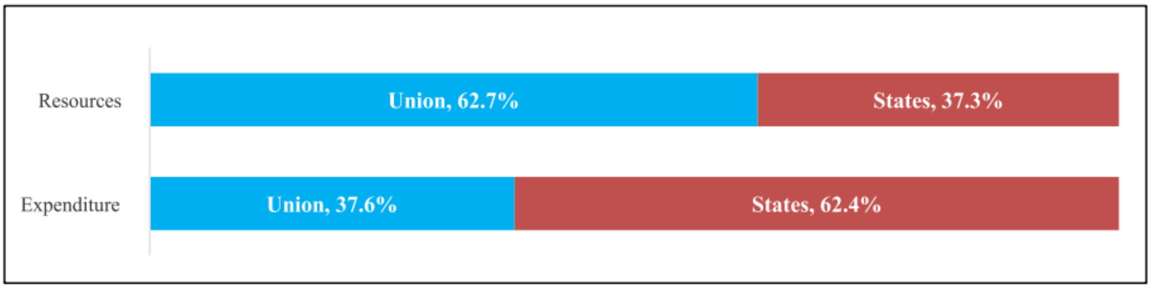
As the Indian Constitution provides for a federal structure of governance, the legislative powers of the central and the state government are demarked into three lists as per Article 246 read with the Seventh Schedule: Union, State and Concurrent list[92]. The union list concerns with matters of national importance such as foreign affairs, war and peace, extradition, defence and so on. Meanwhile the state list contains subjects that are best suited to be addressed by the state level of government like public order, public health, agriculture, water and so on.

These financial provisions must be read in the wider context of India's federal structure. As several scholars have noted, India is an "asymmetric federation,"[93] where the Union exercises much wider powers than the States. This extends to taxation powers as well, important heads such as income tax, excise duties and corporation tax are in the domain of the Union.

To effectively exercise its authority, a government must have adequate financial resources. The Seventh Schedule reveals that while the central government has greater revenue-generating powers, state governments are responsible for significant expenditures related to public order, healthcare, agriculture and so on.

Vertical asymmetry

INDIA'S VERTICAL FISCAL GAP (As on Financial Year 2019-20)



(Figures from the Fifteenth Finance Commission Report[94])

As illustrated by this chart, while the Union government receives approximately two-thirds of the total tax revenue generated, they are only accountable for slightly over one-third of all expenditures. Conversely, the state governments bear the responsibility for nearly two-thirds of all expenditures while receiving only a third of the revenue

The Constitution endeavours to tackle this uneven distribution of financial resources between the central and state governments by establishing provisions for intergovernmental transfers through specific constitutional provisions. These intergovernmental transfers are provided for

[92] INDIA CONST. art. 246
[93] Sujit Choudhry et al., OXFORD HANDBOOK OF THE INDIAN CONSTITUTION (2016)
[94] XV Finance Commission. 'Finance Commission in Covid Times Report for 2021-26' (2020)

in part XII of the Constitution.

1) Article 270 of the Constitution stipulates that all taxes collected by the Union (excluding those already assigned to the states) must be shared between the Union and the states. This includes any surcharges on taxes collected under Article 270(1). After the introduction of the Goods and Services Tax (GST), amendments were made to include the amounts collected under the head of GST in this revenue pool.[95]

Article 280 of the Indian Constitution provides for a Finance Commission to be appointed by the President every five years to recommend the percentage of the devolution of taxes.[96] The finance commission is responsible for deciding how to distribute funds from a divisible pool to different states. This involves determining the percentage of the pool that should be assigned to each state (vertical distribution) and the percentage that should be allocated among the states (horizontal distribution)

2) Article 275 of the Constitution states that "Such sums as Parliament may by law provide shall be charged on the Consolidated Fund of India in each year as grants in aid of the revenues of such States as Parliament may determine to be in need of assistance, and different sums may be fixed for different States"[97]

Thereby this provision enables the parliament to provide grants in the form of aid in favour of a state, based on various parameters, including the states' need for assistance. The Finance Commission has discretion in determining the circumstances in which such grants should be given. These grants are not only used to deal with revenue deficits but also to upgrade administrative and social services, address any specific state need and augment expenditure deployed in the state.

An important objective of such recommendations made by the Finance Commission is to reduce vertical and horizontal fiscal imbalance between the centre and the state.

3) Article 282 empowers both the State and the Union government to "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"[98]

The most significant way in which this grant is exercised is the implementation of Centrally

[95] INDIA CONST. art. 270
[96] INDIA CONST. art. 280
[97] INDIA CONST. art. 275
[98] INDIA CONST. art. 282

Sponsored Schemes (CSS) by the Union Government which is sought to be implemented throughout the country. Notably Article 282 effectively gives the Union the power to frame policy for matters that fall under the state list as the provision enables grants to be made for any public purpose. Further, it is pertinent to note that comparatively, only a small proportion of its overall expenditure towards its primary functions, such as defense and foreign affairs[99]

Unlike the intergovernmental transfers made under Articles 270 and 275, transfers made under Article 282 are not subject to the formal purview of the Finance Commission. This provision has been heavily utilised by the Central government to implement centrally sponsored schemes.[100]

<u>Centrally Sponsored Schemes</u>

Centrally Sponsored Schemes (CSS) are developmental policies formulated by the Union government and executed by the state governments, with financial contributions from the State and the Union governments. They are essentially grants in the form of a policy with a specific purpose. These grants slide into state planning and expenditure, and facilitate the implementation of programs specifically designed by the central government to achieve national priorities

These schemes were initially formulated on 'basic national importance' with a limited number of schemes, they have proliferated enormously in each five-year plan in terms of the quantum as well as their share in the total public expenditure in the country.[101] The Fifteenth Finance Commission identified 131 CSS in place.[102]

The budgetary allocation for CSS has shot up by almost 90% from Rs. 2,31,900 crores in 2016-17 to Rs. 4,42,781 crores in 2022-23[103] and effectively takes up a significant segment of India's policy terrain.

CSS can be characterized as a top-down policy approach. In this framework, the central government holds the authority to design and implement the schemes, while the state governments are responsible for their execution at the local level. This implies that the

[99] R.S Nilakantan, South vs north: India's Great Divide (Juggernaut Books 2022)
[100] Venugopal Reddy & G.R Reddy, Indian fiscal federalism (Oxford University Press 2019)
[101] Subrat Das and Sona Mitra, Restructuring Centrally Sponsored Schemes: A Brief Note on the Recent Policy Measures, Centre for Budget and Governance Accountability (CBGA) India (2013), https://www.cbgaindia.org/working-paper/restructuring-centrally-sponsored-schemes-a-brief-note-on-the-recent-policy-measures/
[102] Junghun Kim & Sean Dougherty, Local Public Finance and capacity building in Asia (OECD Publishing 2021)
[103] Ministry of Finance, Union Budget 2022-2023, (Government of India 2022)

decision-making power predominantly rests with the central government, with the state governments playing a subordinate role in the implementation process.

Under the CSS model, the central government sets the objectives, guidelines, and conditions for the schemes. The states are expected to adhere to these guidelines in order to receive financial assistance provided by the central government. The conditions may include meeting specific targets, adopting certain policies, or complying with prescribed procedures.

This top-down nature of CSSs ensures uniformity and consistency in policy implementation across different states. This is a very sub-optimal policy solution to India's social problems because Indian states are very divergent, as the data on health, education and economy reveals. In health, the difference between the best and worst states is as wide as that between the OECD countries and sub-Saharan Africa. In education, it's as wide as that between middle-income and low-income countries. In terms of economic prospects, the better-off states are two to three times richer than the poorest[104]

Moreover, it is noteworthy that the central government exercises significant control over granular aspects of implementation leaving limited room for states and local governments to adapt the implementation according to their specific jurisdiction. Studies[105] have shown how this has rendered policies inefficient as each state possesses its own distinct challenges, priorities, and developmental requirements. By enforcing a uniform policy framework from the central level, the top-down model neglects the contextual nuances and specific needs of different states. This can lead to inefficient resource allocation and ineffective policy outcomes, as interventions may not be tailored to address the specific challenges faced by each state.

Therefore, this policy imposition by the Union government can limit state autonomy and take up their fiscal space as they have to put up a significant portion of the CSS grant thereby augmenting their fiscal burden.

Additionally, the discretionary nature of the transfers and the lack of transparency in their formulation have raised concerns[106] Specifically, there have been apprehensions regarding the insufficient consultation with states in the formulation of several CSS, which necessitate the adoption of expenditure patterns that do not align with their own priorities.

Over the years, the state government have demanded that CSS be rationalised in order to create

[104] R.S Nilakantan, South vs north: India's Great Divide (Juggernaut Books 2022)
[105] Jay Chaudhuri, Going to the operating room without a diagnostic—reforming centrally sponsored schemes, 9 India Review, 169–203 (2010)
[106] Supra note 3

more fiscal space for them to implement state policies. The Fifteenth Finance Commission has taken up this issue and based on their recommendations, the Union government has cut the quantum of CSS to 28 Umbrella schemes with 6 'Core of the Core', twenty 'Core' and 2 'Optional' schemes.[107] In most of these schemes the ratio of funds is 60:40 with the union pitching in more and 90:10 when it comes to North-Eastern states.

However so, it is important for the Union to determine national welfare priorities, to ensure that all States develop at similar rates and also helps in promoting national unity and integration. Union guidance on State-level policies may also ensure a degree of uniformity in benefits available to residents of different States and to provide some alignment on State priorities. For instance, one of the key objectives of Pradhan Mantri Jan Arogya Yojana (PM-JAY) is to make healthcare accessible throughout India.[108] Likewise, Mahatma Gandhi National Rural Employment Guarantee Act (MGNEREGA) is another landmark scheme that has helped promote rural development and reduce poverty by supplementing private employment in the rural Indian economy with public employment[109] Let us look at some of the specific systemic issues that have hindered the effective functioning of these schemes.

Parallel Authorities and red-tapeism

For the functioning and implementation of CSS, the Union government has had to set up several parallel institutions to ensure the execution and performance of these schemes. However, this has resulted in some unintended consequences as it essentially creates an additional stakeholder in the implementation process which has impeded in the smooth functioning of these policies.

A study analysing institutional architecture for the flow of public fund for the National Health Mission, which is the largest scheme in India's health sector, and constitutes about a third of all Government health expenditures in the country highlights the policy barriers that these parallel authorities cause in the execution of health budgets in India.[110]

The findings of this study reveal how the process of transferring funds from the State treasury to State Health Societies (SHS) in Bihar and Maharashtra is convoluted and time-consuming.

[107] Asit Ranjan Mishra, 15th finance commission recommendations: Centrally funded plans face the axe, Hindustan Times, Feb 03, 2021
[108] Vinod Paul, Ayushman Bharat Pradhan Mantri Jan Arogya yojana (AB PMJAY): Hope for millions and exciting new prospects for neuro-healthcare, 67 Neurology India , 1186 (2019)
[109] Parmod Kumar, MGNREGA: Employment, Wages and Migration in Rural India , 231–258 (Routledge India 2016)
[110] Mita Choudhury and Ranjan Kumar Mohanty, Utilisation, Fund Flows and Public Financial Management under the National Health Mission, Economic and Political Weekly (2019)

The study found that a minimum of 32 desks in Bihar and 25 desks in Maharashtra and 10 in Odisha. Under the National Health Mission, for the implementing agency to utilise the allocated funds under this scheme, they have to go through the institutional architecture composed of several units (at the state, district, block and lower-levels) [111]

This illustrates how the paperwork required for fund release must navigate through multiple hierarchical levels within the State administrative structure before the allocated funds can be disbursed to the State Health Society. The majority of the file movement occurs within the State administrative hierarchy, as the State Governments issue approval letters to release the funds to the SHS.[112]

Consequently, release of funds from the State Health Societies takes 5 months in states like Maharashtra and over 3 months in Bihar and Uttar Pradesh. Studies[113] have highlighted how these repercussions of delays at one level are often felt throughout the system, resulting in the funds reaching the final stage of disbursement only in the last quarter of the fiscal year.

This is crucial as ensuring the streamlining of fund flows under any CSS is indispensable to achieve the national priorities these schemes are implemented for. Several studies[114] [115] [116] analysing various schemes have highlighted policy faults regarding the flow of funds regarding CSS due the nature of top-down planning and complex institutional architecture.

State fiscal autonomy

The scaling up of CSS over the years have resulted in the ability of states in India to finance their current expenditures from their own revenues declining significantly. In 1955-56, states were able to finance about 69% of their current expenditures from their own revenues. However, this has decreased to less than 38% in 2019-20.[117] Meanwhile the budgetary allocation for CSS has shot up by almost 90% from Rs. 2,31,900 crores in 2016-17 to Rs. 4,42,781 crores in 2022-23.

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[111] ibid
[112] ibid
[113] ibid
[114] K. Gayithri, District-level NRHM funds flow and expenditure, 60 The Indian Economic Journal, 89–112 (2012)
[115] Gupta, Manish, Anit Mukherjee, Tapas K. Sen, and R. Srinivasan, "Improving Effectiveness and Utilisation of Funds for Selected Schemes through Suitable Changes in Timing and Pattern of Releases by the Centre.", National Institute of Public Finance and Policy (2011).
[116] BHANUMURTHY N R & AMAR NATH H K, UNSPENT BALANCES AND FUND FLOW MECHANISM UNDER MAHATMA GANDHI NATIONAL RURAL EMPLOYMENT GUARANTEE SCHEME (MGNREGS), National Institute of Public Finance and Policy, (2014)
[117] KALAIYARASAN A, The poor state of India's fiscal federalism, The Hindu, July 08, 2022

The increasing expenditure of CSS has driven state governments to establish their expenditure priorities in alignment with these centrally devised schemes thereby rendering then unable to finance their own needs. Moreover, the CSS approach, characterized by a one-size-fits-all approach, assumes, at a policy level, that all states are equally positioned, disregarding the specific local needs of each state.

Studies have shown decentralizing policy decisions actually results in increased accountability of local politicians thereby, improving both the efficiency and the effectiveness of public services provided to the citizens[118] [119]

States do not have any agency in the formulation of these policies which may not be alignment with the needs and it is the state governments that have a better understanding of the local conditions, culture, and demographics, which can significantly impact policy outcomes. [120]

Another consequence is that certain states have better infrastructure and delivery mechanisms to carry out the schemes laid down by the Union and end up doing better in implementation.[121] A study enquiring into the implementation of National Health Mission illustrates how as a result of having better infrastructure, economically well-off states like Maharashtra and Gujarat secured more than all of the funds allotted, but States like Bihar that aren't as well off, was able to only secure seventy-nine percentage of the funds, due to their inability to fulfil the pre-requisites for funding due to poor implementation.[122] This horizontal imbalance caused by CSS is a natural consequence of centralized planning.

Moreover, the state governments have no agency over determining micro-level aspects of policy. Accepting a conditional grant such as CSS from the Central government results in the state losing any sort of discretion on implementing these policies.

Many of these centrally sponsored schemes happen to be programmes focused on what are explicitly state subjects, or those on the Concurrent List. In most instances, there is no good reason for the Union to spend that directly; these programmes – most of them in the areas of

[118] Srinivasan, T.N. & Seddon Wallack, "Inelastic Institutions: Political Change and Intergovernmental Transfer Oversight in Post-Independence India", vol. 7(1) India Policy Forum, National Council of Applied Economic Research, 203-251 (2011)
[119] Lorenzo Boetti et al., Decentralization and Local Governments' Performance: How Does Fiscal Autonomy Affect Spending Efficiency?, Vol. 68, No. 3 FinanzArchiv: Public Finance Analysis, 269-302 (2012)
[120] Reddy, Supra note 9
[121] Rajeshwari Deshpande et al., States as laboratories: The Politics of Social Welfare Policies in India, 16 India Review, 85–105 (2017)
[122] Avani Kapur, Towards 'Cooperative' Social Policy Financing in India, Centre for Policy Research (CPR) India (June 25, 2019), https://cprindia.org/towards-cooperative-social-policy-financing-in-india/

health, education, agriculture and social welfare – are better designed and administered by state governments.

Studies have shown that when it comes to the provision of public goods and services, greater decentralization of service delivery results in a positive correlation with outcomes and ensures increasing levels of accountability.[123] A strong reason is the vast heterogeneity across territories in India, where local decision-makers are better equipped to make decisions. The more centralized the policy making process is, the more information asymmetry there will be. Lesser information asymmetry implies knowledge of local constraints and preferences making local authorities better equipped to make sound policy decisions.

Structural Concerns and International Perspective

Let us now examine some of the fundamental challenges that pose structural impediments to the effective working of CSS and explore the approaches adopted by other nations in implementing policies of a similar nature.

Policy framing

Currently there exists a lack of engagement among the central government and state governments in the formulation of Centrally Sponsored Schemes (CSS). The Union is responsible for designing the schemes concerning matters of national significance, while the state's role is restricted to executing the policy at the grassroots level. This approach affects the fiscal autonomy of these states where they have to bear the cost of expenditure incurred for the implementation without having the adaptability to align the scheme to local conditions and incentives. Additionally, for a subject matter covered by a CSS, there is no corresponding state-level policy that enables the states to articulate their policy preferences. Therefore, states should be given a more collaborative role in setting these policies.

Inter-Governmental forum

Globally, in countries that follow a federal structure have seen policy implementation done in this manner. A prominent instance being the Australian 'National Health Reform'; the central government, states and local territories are made jointly responsible for administering and delivering a system of public health that is standardized across the nation yet allows for local autonomy and decision-making. This is done through the Council of Australian Governments (COAG), where representatives from all three levels of government gather to formulate and

[123] Supra note 28

administer public policy. It is tasked with identifying goals to be achieved and how it can be achieved through the co-ordinated action by authorities at all the level.

By involving representatives from all levels of government, the policy has been able to take into account the unique needs and circumstances of different regions, while still maintaining a uniform coherent approach across the nation. This can lead to more effective and efficient policy outcomes and ensure national goals are met.

Bilateral agreements

Another route to achieving national goals while preserving sub-national autonomy is through bilateral agreements between the state and the central government defining the terms of the enactment of public policy.

An example of bilateral agreements is the system of State-region plan contracts in France known as Contrat de Projets Etat-Régions (CPER); this functions by integrating national and regional plans, by facilitating a unified, collaborative negotiation process between the union and state government to articulate a clear vision on what is to be achieved by the policy, assessment of the infrastructure needed to be developed to carry out the policy and the terms of their coordination in carrying out the scheme.

The CPER is a contract that is agreed upon by the central state and the regions every five years. The Centre sets out general economic objectives for the country, while each state creates its own plans that align with the national framework. It gives regions the freedom to design and implement their own development strategies, as long as they are in line with the national plan.[124]

In principle, it is used to determine financial transfer from the State to the regions. They can be considered as a means to implement national guidelines and specifications to the regional level, and also as a means for the regions to express their own policy priorities and investments mirroring the policy priorities of the State and the Union.

The CPER is based on the principle of subsidiarity; the idea that policy decisions should be taken at the appropriate level closest to the citizen[125]. Such decisions are decentralized because of the firm policy understanding that these decisions should be taken at the level appropriate to its nature.

[124] Delphine Ancien, Local and regional development policy in France: Of changing conditions and forms, and enduring state centrality, 9 Space and Polity, 217–236 (2005)
[125] John Loughlin et al., Routledge Handbook of Regionalism & Federalism, (Routledge 2020)

The CPER has been regarded for its ability to provide an institutionalized space for negotiation among public actors at various levels, resulting in greater coherence, efficiency, and transparency, as well as fostering synergy around shared objectives and national goals.[126]

Conclusion and Policy Recommendations

Research suggests that national level policies like CSS can help achieve key national goals while being considerate of the state governments fiscal health and material conditions. [127] Well-designed policies at the central level can enhance the fiscal health of subnational governments by ensuring that the grants provided are used in a constructive manner and improve the social conditions of the country. While such top-down policies do impose the union government's policy preferences on the state level, when appropriately designed, uphold state autonomy by engaging the local levels of government in the transmission these schemes thereby striking a balance between national goals and vision with state autonomy and local needs.

The disproportionate levels of centralization in the social policy landscape have led to eroding state fiscal autonomy; this need to be addressed structurally by altering the inter-governmental structures. The effective functioning of national schemes, such as those falling under the Central Sponsored Schemes (CSS), necessitates a collaborative approach between all the levels of Government. In this light, the following recommendations are put forth as policy recommendations.

To enhance the efficacy of these schemes, an agreement-based mechanism between the centre and the state that integrates national and state plans which facilitates a collaborative negotiation process between the central government and the states for framing national policies. The Union government can enter into an agreement with every state regarding formulation and implementation of national objectives. This will maintain consistency with national objective while maintaining state autonomy. Further, involving the third tier of government will result in effective policy decisions.

An intergovernmental forum can be established to serve as a suitable platform for negotiating and implementing such agreements, with technical groups providing support. The use of technical groups to provide support can help to ensure that policies and programs are based on

[126] Cecile Crespy et al., Multi-level governance, Regions and Science in France: Between competition and equality, 41 Regional Studies, 1069–1084 (2007)

[127] Jun Ma, Intergovernmental fiscal transfers in nine countries: Lessons for developing countries, Policy Research Working Papers (1999)

sound evidence and best practices, and that they are designed to achieve their intended outcomes. This can help to build trust and confidence among stakeholders, and can contribute to the overall success of the policy or program.

Forums at all the levels of government represented by authorities may be established to create an arena to carry out tasks such as performance assessment, measurement, supervision, reporting, and conflict management throughout the grant cycle. This can be an effective way to promote collaboration and coordination between different levels of government which is an essential for maintaining federal structures.

Moving forward, it is essential to create a mechanism that ensures fiscal autonomy while addressing centralization concerns by providing room for contestation and negotiation between top-down and bottom-up priorities. Bottom-up inputs can complement top-down planning can result in targeted policies that address the diverse needs of the population while maintaining coherence with national objectives.