Q14

Examine the evolving pattern of Centre-State financial relations in the context of planned development in India. How far have the recent reforms impacted the fiscal federalism in India?

UPSC Civil Services Mains 2025 · GS II · 15 marks · Federal Structure and Devolution

Functions and responsibilities of the Union and the States, issues and challenges pertaining to the federal structure, devolution of powers and finances up to local levels and challenges therein.

Core demand of the question

- Trace Centre-State money in the planned-development decades
- Show Finance Commission, Planning Commission, and grants
- Assess GST, tax devolution, cesses, NITI Aayog and recent borrowing rules as impacts on fiscal federalism

Revision summary

Finance Commissions devolve taxes; Planning Commission Plan grants created a discretionary second channel.

Sarkaria and Punchhi criticised that discretion.

NITI Aayog ended Plan cheques; 14th FC raised the States' share of the divisible pool to 42%.

GST shares tax but limits State rate power; cesses outside the pool and CSS keep Union leverage.

Article 293 borrowing conditions remain a hard federal tool.

Introduction

Fiscal federalism is who raises the rupee and who spends it. In India the Union is the great collector (income tax, now a large share of GST) and the States are the great spenders (health, education, law and order). **Planned development after 1950 deepened that split: Five-Year Plans and a Planning Commission sat beside** the constitutional Finance Commission. Recent reforms have changed the pipes, not the Union's weight.

Body

The planned pattern

Article 280 Finance Commissions recommended tax devolution and grants. **Article 282** allowed the Union to make grants for any public purpose - the hook for **Plan grants**. The Planning Commission, extra-constitutional, allocated **Central assistance** and approved State plans. **Gadgil-Mukherjee** formulae tried to be fair; in practice States bargained in the NDC. **Sarkaria** and later **Punchhi recorded the grievance: discretionary plans** made Chief Ministers lobby Delhi for what the Constitution had already divided.

Tied Centrally Sponsored Schemes proliferated. States became **implementing agencies** with matching shares. Vertical imbalance (Union collects more) plus horizontal imbalance (poor States need more) was managed by FC equalisation **and** Plan politics.

Recent reforms

NITI Aayog (2015) ended Plan grants as a Planning Commission power. It is a think tank, not a cheque-book. That **cleared space for the Finance Commission** - the 14th FC jumped **States' share of the divisible pool to 42% (15th FC: 41% after J&K became UTs). This was the high point of rule-based devolution**.

GST (101st Amendment) fused many State taxes into a shared tax with a **GST Council**. Compensation for five years (cess) cushioned the shock. After compensation ended, States felt the **loss of rate autonomy**. Council voting (weighted toward the Union) is cooperative in form and Union-heavy in arithmetic. **Cesses and surcharges** still sit **outside** the divisible pool, which shrinks the 41% in real life - a standing federal complaint.

COVID-19 extra borrowing, **FRBM** paths, and conditions on State borrowing (**Article 293**) showed the Union as gatekeeper of State credit. **Centrally Sponsored Schemes** remain large. **16th Finance Commission** will reset shares again.

- **Impact: more automatic money via FC, less Plan patronage, more GST jointness, more Union control via cess, CSS and borrowing**. Fiscal federalism is **not** a return to 1950s provincial autonomy. It is **formula plus a strong Centre in the Council and in the bond market**. Punchhi's call for fewer CSS and cleaner devolution is only partly met.

A healthy next step is to **bring a share of cess into the pool**, cap CSS, and let States set more GST-like rates in a band - cooperation without a begging bowl.

Flow diagram

Finance Commission -> Tax devolution

Planning Commission -> Plan grants

Planning Commission -> ended NITI

GST Council Council -> Joint tax

Cess CSS 293 -> Union leverage

Conclusion

Planned development ran a second, discretionary treasury beside the Finance Commission. NITI and the 14th FC strengthened the constitutional channel. GST and cesses, CSS and borrowing rules have recentralised by other means. Fiscal federalism today is a larger guaranteed share inside a still Union-led system.

Facts & figures

14th Finance Commission
Recommended 42% of the divisible tax pool for States, a sharp rise in rule-based devolution.

101st Amendment
Introduced GST and the GST Council as a federal tax body.

Article 293

States need Union consent to borrow if they are indebted to the Union - the legal hook for borrowing conditions.
