



Decoding Indian Federalism

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Indian Federalism: **Key Dimensions**

- India's journey towards federalism has been **robust and promising**
- **Effective decentralisation** from the Union to the State has taken place through the following three pathways

Fiscal

Political

Constitutional

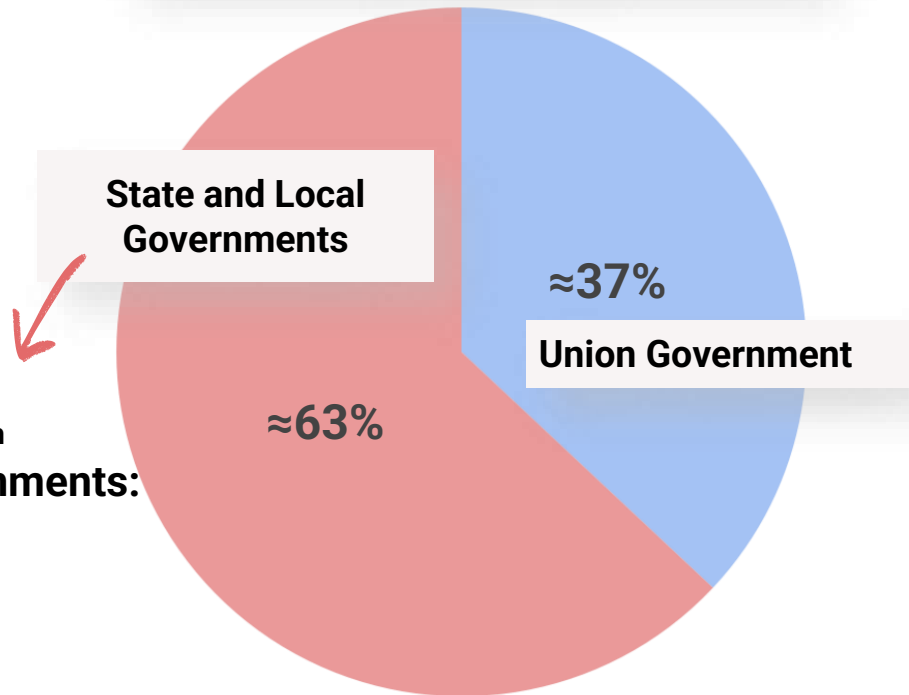
While critical challenges still remain, our successes must be given due recognition



Fiscal Federalism

Fiscal Federalism in India: Key Facts

Government Expenditure (FY 2024-25)



Crucial point often missed in the debate on Fiscal Federalism in India:

≈ 63 to 65%
of the general government expenditure (including local government) occurs at the State level.

Redefined Role of the **Union Government**

After 1991, the Union's role is focused on

**Big Infrastructure
(National Highways)**

Defence

External Affairs

Rationalization of Centrally Sponsored Schemes (CSS)

- **Reduced from ~130 schemes (pre-2014) to 65–75 schemes**
- **Focused on national development priorities**

There is still scope for further improvement.

With economic growth, States' fiscal dependence on the Union has also reduced.

From the IX Finance Commission – Progressive increase in devolution to States.

Finance Commission	Period	Share of Union's Taxes and Duties
VIII	1985 -1989	<i>85% income tax + 45% Union excise duties</i>
IX	1990 - 1995	
X	1996 - 2000	29%
XI	2001 - 2005	29.5%
XII	2006 - 2010	30.5%
XIII	2011 - 2015	32%
XIV	2016 - 2020	42%
XV	2021 - 2026	41%
XVI	2026 - 2031	41%

Arbitrary, ad hoc, and limited divisible pool

Expanded divisible pool and a fixed share of all Union taxes

Sources: Finance Commission of India. (Respective years).

Transfer of Resources to States

≈54% of the Gross Revenues of the Union are transferred to the States.

Heads (Rs. Crores)		2023-24	2024-25	2025-26 RE	2026-2027 BE
A	Gross Revenue of the Union Government*	₹36,96,427	₹40,24,537	₹43,69,844	₹46,79,314
B	Resources Transferred to States and UTs with Legislatures	₹20,58,327	₹21,94,971	₹22,38,512	₹25,16,141
	-Devolution of States share in Taxes	₹11,29,494	₹12,86,885	₹13,92,971	₹15,26,255
	-Other Transfers including Finance Commission Grants and Centrally Sponsored Schemes	₹9,28,833	₹9,08,086	₹8,45,541	₹9,89,886
	Resource Transfer as % of Gross Revenue	55.7%	54.5%	51.2%	53.8%
C	Net Revenue with the Union after Transfers (A-B)	₹16,38,100	₹18,29,566	₹21,31,332	₹21,63,173
D	Salaries and Pensions (including Defence)	₹7,44,272	₹8,13,917	₹8,53,011	₹8,90,311
E	Interest Payments	₹10,63,872	₹11,15,575	₹12,74,338	₹14,03,972
F	Structural Deficit of the Union (A-B-D-E)	-₹170,044	-₹99,926	₹3,983	-₹131,110

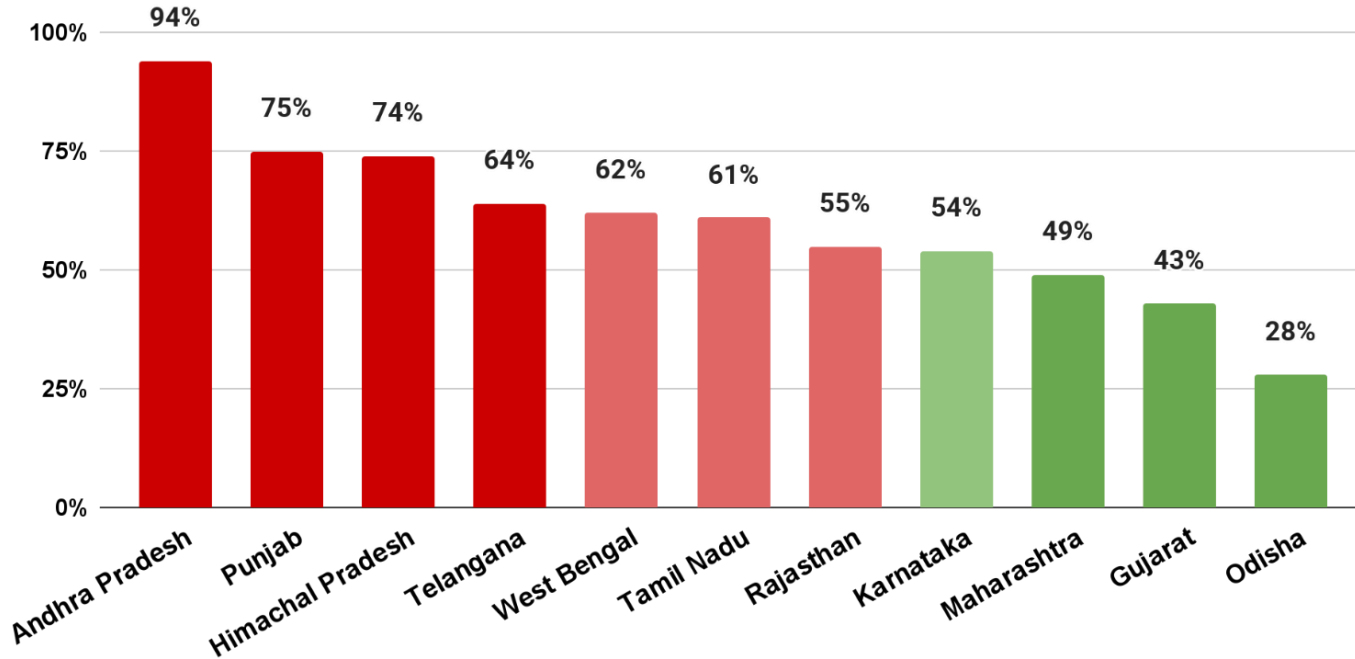
Source: Budget at a Glance, Union Budget Document of 2024-2025; .Expenditure Full Profile, Union Budget Documents of 2024-2025

Note: Gross Revenue of the Union Government = Gross Tax Revenue + Non - Tax Revenue (excluding Dividends and Profits, and capital receipts).

The Union and State governments worked together to simplify indirect taxation.

- The **101st Constitutional Amendment** introduced GST, allowing **concurrent taxation by the Union and the States**.
 - The Union and the States gave up exclusive taxing powers to enable **uniform indirect taxation**.
- The **GST Council (Article 279A)** was created as a unique federal institution.
 - **Chair: Union Finance Minister; Members: State Finance Ministers** (or other Ministers nominated by the States.)

Committed Expenditure as a Share of Total Revenue Receipts (2024-25 RE)

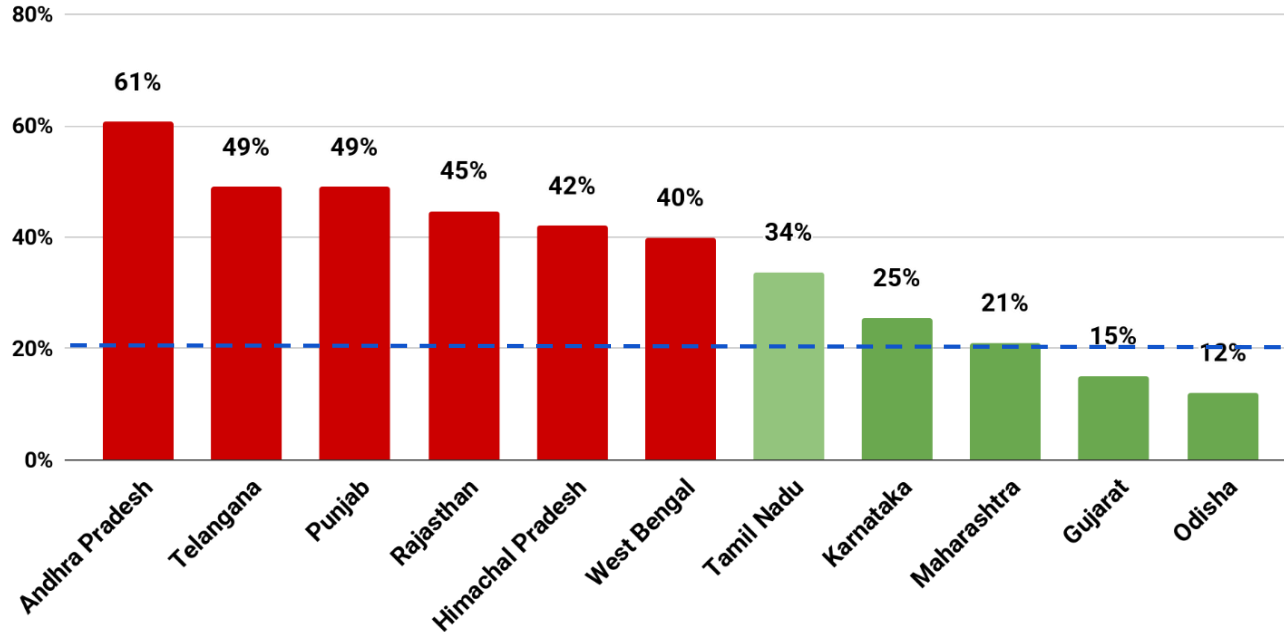


In many States, **salaries, pensions, and interest payments exceed their own revenues** and account for a major share of total revenues.

Coupled with high welfare and administrative spending, this leaves **States reliant on heavy borrowing to meet current expenditure.**

Note: Total Revenue Receipts= State's Own Tax Revenue+State's Own Non-Tax Revenue+State's Share in Union Taxes and Grants-in-aid

Debt-to-GSDP Ratio (2024-25 RE)

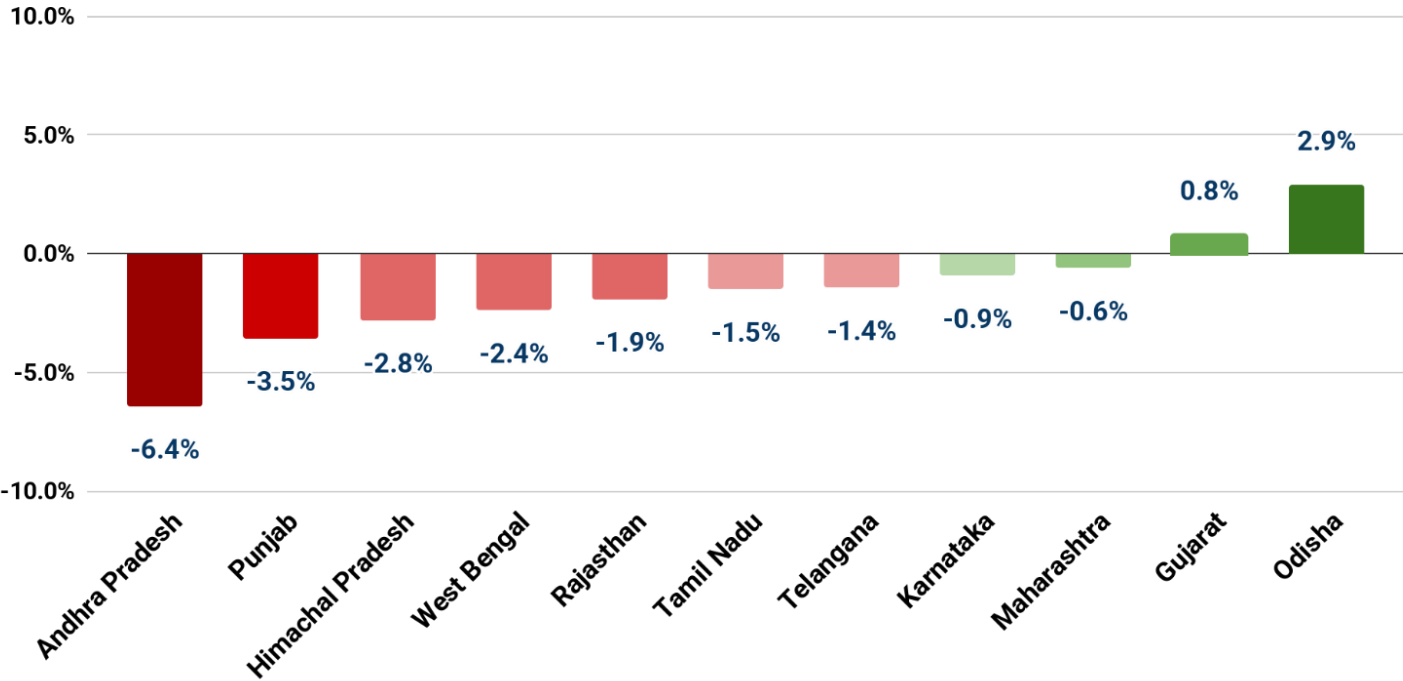


**FRBM Target:
20%**

Note: Debt includes guarantees provided by the State government to corporations and special purpose vehicles (SPVs); for Andhra Pradesh and Telangana, it also includes pending bills.

Source: Respective State Budget Documents 2025-26; Andhra Pradesh and Telangana figures calculated by the FDR based on state White Papers; CAG

Revenue Deficit / Surplus as a percentage of GSDP (2024-25 RE)



Note: Revenue deficit for Andhra Pradesh includes outstanding dues averaged over five years, while Telangana's includes outstanding dues averaged over three years.

Source: Respective State Budget Documents 2025-26; Andhra Pradesh and Telangana figures calculated by the FDR based on state White Papers; CAG Monthly Indicators; and Budget at a Glance.

A Framework for Fiscal Prudence: *Key Recommendations*

- **Nil Revenue Deficit**
- **Freeze welfare expenditure** or allow only modest growth, much lower than the nominal GSDP growth rate.
- **Transparent Accounting**
 - **Off-budget borrowings and Deferred bills** should be disclosed in the budgets.
 - **Repayment capacity** of the organization (SPV), where the government guarantees the borrowing, should be disclosed.
- **Cost-Benefit Analysis** of major capital projects (e.g., Kaleshwaram Lift Irrigation Scheme)

Article 293 - Union has the responsibility to monitor and regulate the fiscal health of States

Local Governments in India: Overstructured & Underpowered

Share of General Government Expenditure in Select Countries (%)

Country	Federal Government	State/ Provincial Government	Local Government
Brazil	63	21	16
Canada	36	47	17
China	15	31	54
Germany	51	32	17
South Africa	47	32	21
Spain	53	35	12
United States	56	22	22
India	37	60	3

Transfer of Funds from the Union Government

Finance Commission	Annual transfers from the Union Government to Local Governments as a percentage of the total devolution to States (%)
XII FY 2006 to FY 2010	3.5
XIII FY 2011 to FY 2015	5.3
XIV FY 2016 to FY 2020	7.8
XV FY 2021 to FY 2026	7.8

China's local governments have been pivotal in driving economic growth.

- **Financially empowered** local governments, with over **50%** of total public expenditure occurring at the local level.
- Greater **functional autonomy**, with leaders of high-performing local governments rewarded, creating healthy **competition to attract investments**.
- **Incentivising provinces to financially empower local governments**, with greater funding support for those that devolve more resources.

Strong Local Governments → Urbanization & Faster Economic Growth



Political and Constitutional Federalism

Federalism: Political Federalism

Pre 1991

- **Single party dominance** across all tiers of government.
- **Limited** autonomy of State governments.
- Near **total command** over resource generation and deployment with the **Union**.
 - **PSU** Investments
 - **Centralised** planning
- Frequent use of **Article 356** to dismiss State governments.

Post 1991

Rise of **coalition governments**:

- No single party achieved independent majority (until 2014).
- Regional parties gained bargaining power.

Emergence of strong **regional parties**:

- States gained leverage in Union-State negotiations
- Led to cooperative and competitive federalism

Federalism: Constitutional Federalism

Pre 1991

VIIth Schedule of the Indian Constitution

- **Division of power** between levels of government viz. Union and States.

Article 356 of the Indian Constitution

- The Article states if a state is unable to function according to Constitutional provisions, the Union government seizes control over the state machinery.
- This Article **was used arbitrarily** to dismiss state governments for political reasons.

Post 1991

Constitutional Mandate for Local Governance (1992-93)

- Building upon the framework in the VIIth Schedule, the 73rd and 74th Amendments **attempted to further decentralise governance** and institutionalise local self-governments in rural and urban areas.

Article 356 and the Bommai Judgment (1994)

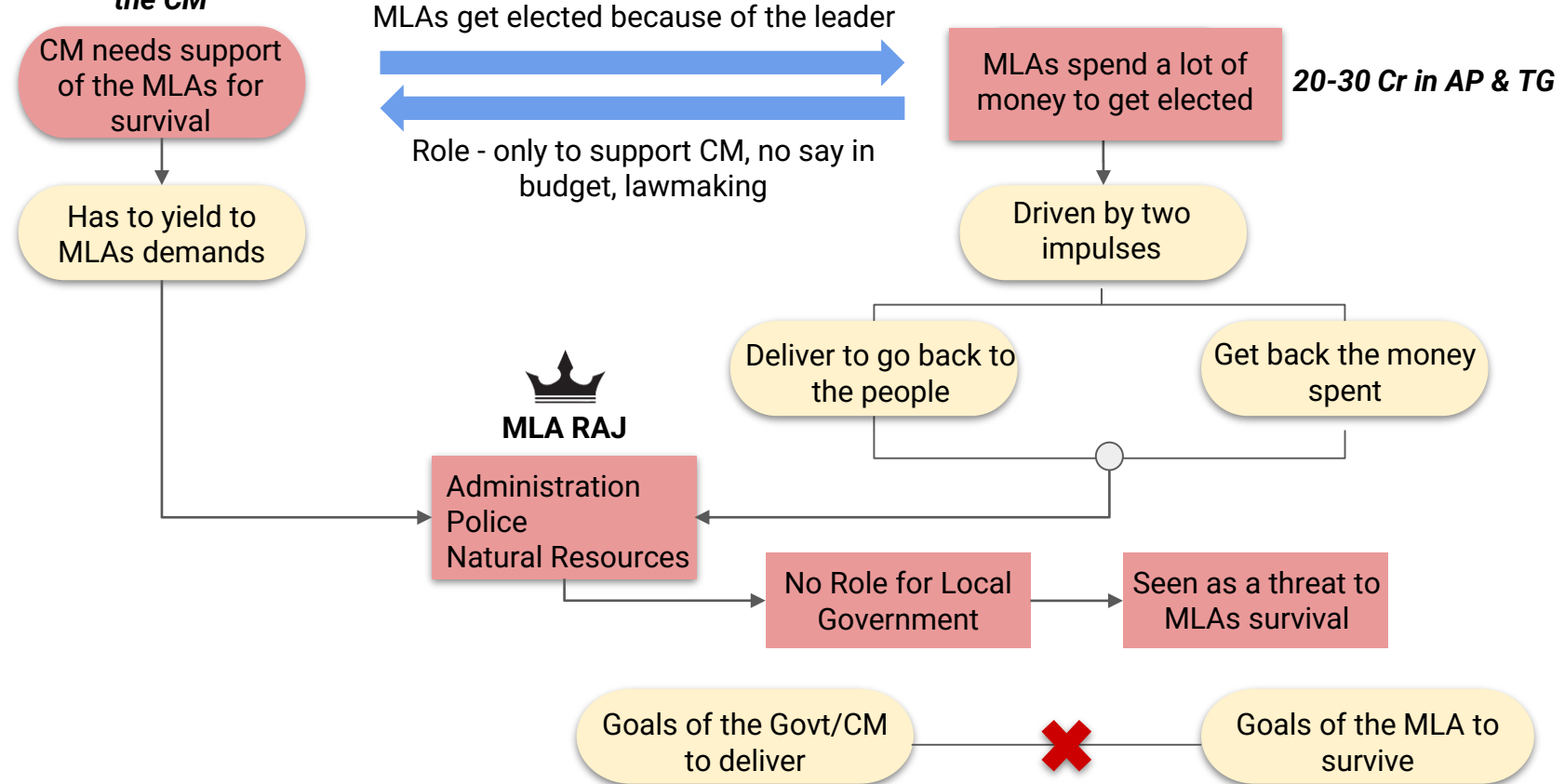
- Supreme Court curtailed presidential discretion.
- Established **judicial review** over Article 356 imposition.



Existing & Emerging Challenges

EXISTING POLITICAL AND GOVERNANCE CHALLENGES

Power Centralized with the CM



Centralised State Polity

- While the Union devolved powers to States; States failed to devolve to local governments.
- The vacuum created by the absence of strong local governments leads to the MLAs being the uncrowned kings of the constituencies.

EXISTING POLITICAL AND GOVERNANCE CHALLENGES



Current local governments



Over-structured

Underpowered

No link between:

Vote



Public Good

Taxes



Services

Authority



Accountability

Inefficient & corrupt service delivery

Vote becomes a purchasable commodity and populism becomes endemic

Inter-State Water Disputes

- Need stronger Union intervention.
- Ensures equitable and efficient distribution transcending state parochialism and provide enforcement authority that current inter-state boards lack.

Federal Offences

- Modern crimes operate across jurisdictions.
- Areas such as **terrorist offences, cyber crimes, financial frauds**, etc. need interdependence and federal coordination.

Delimitation and Representation (42nd & 84th Amendments):

- States with slower population growth will lose seats.
- Changes coalition dynamics and party strengths.

Tax-to-benefit balance & equity

- Weaker states need support to provide basic services.
- Excessive transfers reduce fiscal incentive for revenue generation.
- Fiscally stronger states feel penalized for development and efficiency.

XVI FC

Added a new parameter for horizontal devolution - **Contribution to GDP** assigned a weight of 10% in the formula

Per Capita Government Expenditure (State-wise)

States	Total Expenditure (Rs. Crores)		Population (Crores)		Per capita Expenditure (Rs.)	
	2024-25	2025-26 RE	2024-25	2025-26	2024-25	2025-26 RE
Andhra Pradesh	₹3,00,535	₹3,32,205	5.35	5.37	₹56,150	₹61,859
Tamil Nadu	₹4,39,895	₹4,78,360	7.73	7.75	₹56,895	₹61,687
Telangana	₹2,66,035	₹3,04,964	3.85	3.86	₹69,183	₹78,933
Kerala	₹1,92,456	₹2,39,907	3.61	3.62	₹53,366	₹66,260
Karnataka	₹3,68,419	₹3,95,307	6.85	6.90	₹53,754	₹57,322
Orissa	₹2,27,021	₹2,90,000	4.69	4.71	₹48,450	₹61,510
Gujarat	₹3,12,988	₹3,65,747	7.32	7.41	₹42,742	₹49,368
Bihar	₹2,81,939	₹4,23,284	13.04	13.23	₹21,616	₹32,003
West Bengal	₹3,07,216	₹3,46,692	10.00	10.01	₹30,709	₹34,651
Punjab	₹1,45,884	₹1,73,601	3.11	3.13	₹46,875	₹55,432
Uttar Pradesh	₹6,03,148	₹7,16,231	24.05	24.29	₹25,082	₹29,492
Maharashtra	₹6,48,615	₹8,13,476	12.83	12.93	₹50,541	₹62,910
Madhya Pradesh	₹3,45,938	₹3,79,839	8.86	8.97	₹39,027	₹42,358
Rajasthan	₹4,53,066	₹5,58,596	8.28	8.36	₹54,738	₹66,784

Source: Respective State Budgets

Expenditure figures are based on **Actuals, Revised Estimates (RE), or Budget Estimates (BE)**, depending on the latest available data

Governors as crude political tools

- Have the potential to undermine State autonomy and reduce legitimacy of elected governments.
- Create trust deficit in Union-State relations.
- Threaten democratic stability in States.

One Nation, One Election

- Possibility of regional issues being subsumed under national political narratives.
- Favours large, centrally-organised national parties.
- Undermines competitive federalism where states offer alternative governance models.

“The first lesson of economics is scarcity: There is never enough of anything to satisfy all those who want it. The first lesson of politics is to disregard the first lesson of economics.”

-Thomas Sowell



END