Azim Premji University Report Highlights Growing Fiscal Burden on States in Financing India's Expanding Welfare Architecture

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Recent Developments:

- The **Azim Premji University** report titled **"Realising Rights: A Handbook of Welfare in India"** highlights that **State Governments** finance a disproportionately large share of India's welfare expenditure despite shrinking fiscal autonomy and increasing dependence on Union transfers.
- The report argues that growing reliance on **Centrally Sponsored Schemes (CSS)**, declining effective tax devolution, expansion of **cesses and surcharges**, and reduced taxation autonomy after **Goods and Services Tax (GST)** have widened **Centre-State fiscal imbalances**.
- It recommends strengthening **Cooperative Fiscal Federalism** through higher untied transfers, rationalisation of CSS, stronger **State Finance Commissions (SFCs)**, protection of States' revenue powers and adoption of the **Funds-Follows-Functions** principle.

Evolution of India's Welfare Regime:

State-Led Welfare Phase (1950s–1980s):

- Welfare policy was closely linked with planned economic development, poverty alleviation and rural transformation through direct State intervention.
- Major initiatives included the **Community Development Programme (1952)**, **Integrated Child Development Services (ICDS) (1975)** and the **Minimum Needs Programme (1975)**, which expanded access to education, health, nutrition and rural infrastructure.

Targeted Welfare Phase (1990s):

- Economic liberalisation and fiscal constraints shifted welfare policy from universal subsidies towards targeted assistance for vulnerable groups.
- Schemes increasingly differentiated beneficiaries using poverty-based criteria, including the **Targeted Public Distribution System (TPDS)** introduced in **1997**, based on **Below Poverty Line (BPL)** and **Above Poverty Line (APL)** classifications.

Rights-Based Welfare Phase (2000s–2014):

- Welfare gradually evolved into a framework of legally enforceable entitlements, making governments accountable for service delivery.
- Landmark legislations included the **Right to Information Act, 2005**, **Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA), 2005**, **Right of Children to Free and Compulsory Education Act, 2009**, and the **National Food Security Act (NFSA), 2013**.

Technology-Driven Welfare Phase (Present):

- Digital governance transformed welfare delivery through the **Jan Dhan–Aadhaar–Mobile (JAM) Trinity** and **Direct Benefit Transfer (DBT)** architecture.
- Schemes such as **Pradhan Mantri Kisan Samman Nidhi (PM-KISAN)** increasingly focus on direct income support, reflecting a shift from entitlement-based welfare towards beneficiary-oriented welfare delivery.
- Technology has improved transparency, reduced leakages and enabled targeted benefit delivery while expanding financial inclusion.

Current Status of Welfare Expenditure in India:

Coverage Expansion with Limited Fiscal Commitment:

- Welfare programmes have expanded significantly, with approximately **14 lakh Anganwadi Centres** operating across the country and subsidised food grains reaching more than **81 crore beneficiaries**.
- Despite this expansion, public expenditure on welfare remains below several recommended policy benchmarks.

Social Security Expenditure Gap:

- Combined expenditure of the Union and States on welfare accounts for nearly **7% of Gross Domestic Product (GDP)** and around **21% of total public expenditure**.
- Although India's **Tax-to-GDP Ratio** is comparable to many middle-income countries, expenditure on social protection remains relatively low as a proportion of GDP.

Centre-State Fiscal Asymmetry in Welfare Financing:

Disproportionate Welfare Responsibility of States:

- Combined allocations for selected welfare sectors during **Financial Year 2025–26** amount to nearly **?24.20 lakh crore**, equivalent to about **6.77% of GDP**.
- The Union Government contributes only around **1.89% of GDP**, while States finance the majority of welfare expenditure.

Declining Effective Tax Devolution:

- The **14th Finance Commission** recommended **42%** tax devolution to States, while the **15th Finance Commission** recommended **41%**.
- However, effective devolution has remained around **29–32%** because a growing share of Union tax revenue is collected through **cesses and surcharges**, which are excluded from the divisible pool.
- The share of cesses and surcharges increased from nearly **10.4%** of Gross Tax Revenue in **2011–12** to more than **20%** by **2021–22**, reducing the untied resources available to States.

Growing State Expenditure on Social Services:

- States account for nearly **75.2%** of total expenditure on school education, making them the principal financiers of public education.
- States also bear substantial expenditure on public health, nutrition, food distribution and unconditional cash transfer schemes.
- According to the **16th Finance Commission**, States spend approximately **?4.14 lakh crore** annually on unconditional cash transfers, significantly increasing their fiscal obligations.

State Innovations and Fiscal Challenges:

States as Laboratories of Welfare Innovation:

- Several successful national welfare programmes originated as State-level initiatives before being adopted by the Union Government.
- **RythBandhu** of Telangana and **KALIA** of Odisha provided the policy foundation for **PM-KISAN**.
- **Tamil Nadu's Mid-Day Meal Scheme** later evolved into the national **PM POSHAN** programme.
- Despite pioneering innovative welfare models, fiscally active States often face borrowing restrictions and fiscal deficit constraints.

Challenges Associated with Centrally Sponsored Schemes (CSS):

Fiscal and Administrative Concerns:

- Many schemes such as **Integrated Child Development Services (ICDS)** and **Pradhan Mantri MatrVandana Yojana (PMMVY)** operate under a **60:40 Centre-State funding pattern**, requiring States to mobilise matching resources.
- Proposed changes in rural employment programmes are expected to increase the financial contribution required from States.
- Release of Central assistance is frequently linked to policy reforms or mandatory implementation conditions, reducing States' fiscal flexibility.
- Under the **PM SHRI Scheme**, States were required to sign a **Memorandum of Understanding (MoU)** with the Union Government before receiving financial assistance, leading to concerns regarding federal autonomy.

Impact of Goods and Services Tax on Fiscal Federalism:

Reduction in Revenue Autonomy:

- The introduction of **Goods and Services Tax (GST)** subsumed several major State taxes, limiting States' independent taxation powers.
- States now depend significantly on the **GST Council**, Central tax devolution and compensation mechanisms for revenue stability.
- This has created a structural imbalance between constitutional expenditure responsibilities and available revenue sources.

Emergence of Fiscal Dependency:

- Shrinking untied transfers, tied CSS assistance, reduced taxation autonomy and borrowing restrictions have increased States' dependence on Union-controlled fiscal instruments.
- Such trends risk transforming **Cooperative Federalism** into a system of **Coercive Fiscal Federalism**, where expenditure responsibilities are decentralised but financial autonomy remains centralised.

Constitutional and Institutional Framework:

Relevant Constitutional Provisions:

- **Article 246A** provides concurrent taxation powers to Parliament and State Legislatures for GST.
- **Article 270** governs distribution of taxes between the Union and the States.
- **Article 275** provides for statutory grants-in-aid to States.
- **Article 280** establishes the **Finance Commission** to recommend tax devolution and grants.
- **Article 279A** establishes the **GST Council** as the institutional mechanism for cooperative fiscal decision-making.
- **Article 293** regulates State borrowing from the Union Government.

Measures Required to Reduce the Welfare Burden on States:

Strengthening Fiscal Federalism:

- The share of **cesses and surcharges** should be rationalised and confined to specific, temporary purposes to preserve the integrity of the divisible pool.
- **Centrally Sponsored Schemes** should undergo periodic rationalisation, with greater reliance on untied grants and flexible funding.
- The recommendation of the **Punchhi Commission (2010)** that CSS should remain limited to matters of national importance deserves greater implementation.
- A statutory **Fiscal Council**, as recommended by the **N.K. Singh Fiscal Responsibility and Budget Management Review Committee (2016)**, should independently assess fiscal sustainability and improve Centre-State fiscal coordination.
- Residual taxation powers of States should be protected to preserve fiscal autonomy in the post-GST framework.
- Fiscal transfers should better reflect differences in revenue capacity, demographic pressures, developmental needs and welfare expenditure across States.
- **State Finance Commissions (SFCs)** should be constituted regularly and their recommendations implemented in a time-bound manner to strengthen fiscal decentralisation.
- **Panchayati Raj Institutions (PRIs)** and **Urban Local Bodies (ULBs)** should receive greater authority to mobilise property taxes, user charges and other local revenues.
- Institutional forums such as the **Inter-State Council**, **Finance Commission** and **GST Council** should facilitate continuous political dialogue on fiscal issues.
- Fiscal transfers should increasingly follow the **Funds-Follows-Functions** principle, ensuring that revenue powers correspond to expenditure responsibilities.

Important Judicial Developments:

Recent Supreme Court Judgments:

- The **Mineral Area Development Authority (MADA) v. Steel Authority of India Limited (SAIL), 2024** judgment reaffirmed significant State taxation powers relating to mineral rights.
- The **State of Uttar Pradesh v. Lalta Prasad Vaish, 2024** judgment reinforced constitutional protection for State taxation powers relating to industrial alcohol.
- These decisions strengthen the principle that constitutionally assigned State revenue sources should not be unduly diluted.

UPSC Relevance:

GS Paper II:

- **Centre-State Relations**, **Fiscal Federalism**, **Finance Commission**, **Cooperative Federalism**, **Governance**, **Welfare Policies**.

GS Paper III:

- **Inclusive Growth**, **Public Finance**, **Fiscal Policy**, **GST**, **Social Sector Financing**, **Economic Development**.

Prelims Pointers:

- **Finance Commission** is constituted under **Article 280**.
- **GST Council** is established under **Article 279A**.
- **Article 270** governs distribution of Union taxes.
- **State Finance Commissions** are constituted under **Articles 243-I** and **243-Y**.
- **Cesses and surcharges** do not form part of the divisible pool of taxes shared with States.

Value Addition for UPSC:

Key Concepts and Committees:

- **Vertical Fiscal Imbalance** refers to the mismatch between revenue-raising powers and expenditure responsibilities across different levels of government.
- **Horizontal Fiscal Imbalance** refers to differences in fiscal capacity and expenditure needs among States.
- The **Second Administrative Reforms Commission**, **Punchhi Commission**, and successive **Finance Commissions** have consistently emphasised strengthening **Cooperative Fiscal Federalism** through greater fiscal autonomy, predictable devolution and institutional dialogue.
- Sustainable welfare financing requires balancing **macroeconomic stability**, **fiscal responsibility**, **State autonomy**, and **equitable social sector investment**, thereby ensuring effective implementation of the **Directive Principles of State Policy (DPSPs)** while preserving India's federal constitutional structure