
EFFECT OF CENTRALLY SPONSORED SCHEMES ON CENTRE-STATE FISCAL RELATIONS

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Introduction

Centrally Sponsored Schemes and Central Sector Schemes are two categories of central welfare programs, that are government-operated programs designed to help people who lack the ability to sustain themselves financially and through other means. They are schemes that are executed by state governments under the direction of the central government with a certain shareholding. As the federal government has greater resources available, these programs are meant to support state government efforts.

In India where the population is so large and poverty is high, the provision of welfare programs to the citizens of this country has become a norm. The Central Government designs a number of Centrally Sponsored Schemes (CSS) which are majorly funded by it but are executed by states. Some examples of CSS are the Ayushman Bharat, Free and Compulsory Education to Children, etc.

But the rising number of CSS over the years has also brought scrutiny towards itself. The growing centralization of social policies has brought about a change in expenditure in the social sector. Not only in expenditure but the state social policies and planning mechanism also get affected in the whole process. Therefore, CSS has become one of the contentious aspects of Indian planning and the fiscal relationship between the centre and states.

This has significant consequences on the fiscal position of a State as the schemes are co-funded by states also. Autonomy to states in matters of fiscal decisions is also important to them so that they can devise and implement policies according to the local requirements. States in India are very diverse not just in terms of culture but also on the economic front too, so the fiscal requirements of one state differ from another drastically, so the one-fit policy designed by the Centre might not always work for all states and provide uniform results. This paper will study the effect of centralization through Centrally Sponsored Schemes (CSS) on the fiscal relation between Centre-State.

Constitutional Provisions with Regard to CSS

India is a “union of states” as per Article 1 of the Constitution of India, which implies that India has a federal structure with features that are unitary in nature. India is made up of states that differ widely in their socio-economic conditions and developmental priorities. Therefore, there needs to be a harmony between the control of the centre and autonomy of the states so that equitable growth and efficient administration take place.

1) Basis for CSS in Directive Principles of State Policy

Part IV of the Indian Constitution provides the Directive Principles of State Policy, which serve as a guiding philosophy for shaping government policies across all branches. They are meant to direct governance at every level and form the constitutional foundation for national initiatives in areas such as reducing inequality¹, promoting education², advancing the welfare of weaker sections³, and improving public health⁴.

2) Fiscal Federalism as per the Constitution

The Constitution clearly defines the competence of legislative powers of the State and the Centre. The Union has the powers to make laws on matters given under the Union List and the state is to frame laws on matters provided in the State List of the Seventh Schedule⁵. On the subject provided in the Concurrent list, the Centre and State, both have the power of law making. The Parliament also possesses the power to legislate on those matters that have not been specifically given under any list according to the residuary powers⁶ and List I of Entry 97 of the constitution.

Similarly, the powers relating to finances and taxation of the Centre and State have been demarcated. The three lists not only differentiate the legislative powers of the center and state but also set out the power to tax. Article 266⁷ states that the revenue amassed by the State and Centre in the form of public money and tax go into the Consolidated Funds of India and States

¹ INDIA CONST. art 38

² INDIA CONST. art 45

³ INDIA CONST. art 46

⁴ INDIA CONST. art 47

⁵ INDIA CONST. art 246, cl. 1

⁶ INDIA CONST. art 248, cl. 1

⁷ INDIA CONST. art 266, cl. 1

and the exceptions to these have been provided under Articles 268⁸ and 269⁹.

Article 270¹⁰ outlines the allocation of taxes and duties that has been amassed by the Union government between the states and itself, as prescribed by the President following the recommendations made by the Finance Commission. The Finance Commission is formed as per Article 280¹¹ and has the responsibility to recommend the quantum of division of taxes among the States and the Centre. Additionally, Article 275¹² of the Constitution makes provision for grants-in-aid from the Union to the states, tailored as per developmental requirements.

3) Fiscal Transfers Scope in the Constitution

The Constitution's framework makes provisions for intergovernmental transfers under particular sections to alleviate this vertical budgetary imbalance. Under the sub-chapters of Distribution of Revenues between the Union and the States¹³ and Miscellaneous Financial Provisions¹⁴, Part XII of the Constitution provides a thorough framework for transfers. There are multiple channels through which the Union government transfers resources to State governments. Articles 270 and 275 define the framework for sharing taxes that are levied and collected by the Centre, and specify how financial assistance to States should be disbursed following Finance Commission guidance. Article 282 further allows both the Centre and States to extend discretionary grants for any 'public purpose,' even in areas outside their legislative authority.

Purpose of Centrally Sponsored Schemes

Federal Structures are characterized by both vertical and horizontal imbalances due to unequal distribution of revenue and expenditure. Horizontal imbalances are also found in between different states. Varying capacities in terms of income, tax base, and cost disabilities affect the fiscal place of a state. The Finance Commission has been given the responsibility by the

⁸ INDIA CONST. art 268, cl. 2

⁹INDIA CONST. art 269, cl. 2

¹⁰INDIA CONST. art 270

¹¹ India Const. art 280

¹² India Const. art 275

¹³ India Const. arts 268-281

¹⁴ India Const. arts 282-291

Constitution to suggest measures to correct the various imbalances by transfers i.e., through tax devolution and grants.

Such transfers may be general-purpose (unconditional) or earmarked for a specific purpose. General-purpose transfers aim to help all states deliver comparable levels of public services at similar tax rates¹⁵. In contrast, specific-purpose transfers are conditional, intended to maintain minimum standards of public services. Finance Commission transfers are largely unconditional, whereas most specific-purpose grants are provided through Centrally Sponsored Schemes and Central Sector Schemes.

Both unconditional and conditional transfers help address the imbalances in the fiscal federal structure by supplying states with resources based on factors such as population, area, geography, and income levels, enabling them to deliver public services at more uniform levels across the country.

Centrally Sponsored Schemes are development initiatives that are crafted by the Union Government but implemented by the State Governments¹⁶. Essentially, they are policy-driven grants provided by the Centre to the states to achieve specific objectives of national importance¹⁷. These grants become part of the state planning and spending, enabling the execution of programs that have been tailored by the Central Government to address national priorities. However, the whole scheme is not completely sponsored by the Centre and the states also have to contribute some proportion of the expenditure of the scheme.

Even though CSS might look contrasting in the federal structure of India as the Central legislative powers and State legislative powers is strictly demarcated in the Seventh schedule of the Indian Constitution, it is Article 282¹⁸ which enables the Union to allocate funds from its budget for CSS even though it might not have the legislative competence to make laws on that subject, for 'public purposes'.

Previously, that is from 1950 to 2014 the Grants to States were decided by the Planning

¹⁵ M. Govinda Rao, Central Transfers to States in India: Rewarding Performance While Ensuring Equity : Report submitted to NITI Aayog (2017).

¹⁶ NITI Ayog, Report of The Sub-Group of Chief Ministers on Rationalisation of Centrally Sponsored Schemes (2015)

¹⁷ *ibid*

¹⁸ *Supra* Note 5

Commission which was headed by the Prime Minister¹⁹. The states were also required to bear a certain part of the funds with respect to each sector²⁰. In addition to the Planning Commission, the National Development Council was also another body that helped in the making of the Central Welfare schemes²¹. But in 2014 the Planning Commission and National Development Council were wrapped up and NITI Ayog was introduced which is also headed by the Prime Minister²², however it is a non-statutory body.

The Niti Ayog doesn't make Five Year Plans like the Planning Commission but has a key role in the formulation of CSSs. So even if there are no more regular plan devolutions now, the discretionary transfers from Centre to State are present in large numbers, the majority of which are CSS that are designed by the Center and carried out by States according to the terms of the Center²³. The other portion of the funds are used in Central Sector Schemes that are framed as well as implemented by the Central Government in States²⁴.

Issues against CSS

CSS is described as a top-down policy where the union has the power to formulate schemes while the states are only given the responsibility to implement this plan at the grassroots level²⁵. Principal decision-making authority is vested in the union government, whereas state-level governments operate as subordinates charged with executing those decisions. This hierarchal structure of CSS is meant to ensure consistency and uniformity in policy implementation across states²⁶. However, this approach may not be optimal for addressing India's diverse social issues, given the considerable variations among Indian states in terms of health, education, and economic indicators.

CSS was initially started with a motive to focus on issues of national importance and so were limited in number. However, over time they have witnessed a substantial increase both in the number as well as the expenditure spent on it. The Fifteenth Finance Commission has identified

¹⁹ Nirvikar Singh, *Fiscal Federalism*, in THE OXFORD HANDBOOK OF INDIAN CONSTITUTION 851 (Sujit Choudhry et al. eds., 2016).

²⁰ Y. V. REDDY & G V REDDY, INDIAN FISCAL FEDERALISM (2019)

²¹ Prabhat Pattnaik, *From the Planning Commission to NITI Ayog*, 50(4) ECON. & POL. WKLY. (2015)

²² *ibid*

²³ Bibek Debroy, *Restructuring of Centrally Sponsored Schemes Cannot be Done Without Consultation with States.* FIN EXPRS, Sept. 12, 2019

²⁴ *ibid*

²⁵ Gauthaman V., *Preserving Fiscal Autonomy in the Indian Social Policy Landscape: Addressing Centralization and Inter-Governmental Structures*, 8 NUJS J. REGUL. STUD. 36 (2023).

²⁶ *ibid*

that 131 Centrally Sponsored Schemes (CSS) are in operation currently²⁷. Approximately 27% of the transfers to states in the Union Budget for the fiscal year 2020-21 amounting to more than 33 lakh crore, were allocated for CSSs²⁸. The budgetary allocation for them has also seen a surge of 90% increasing from Rs 2,31,900 crores in 2016-17 to Rs 4,42,781 crores in 2022-23²⁹. This shows the substantial presence of CSS in India's policy landscape.

Over time state governments have advocated for the rationalization of CSS to allow for greater fiscal flexibility in implementing state policies. This demand has been addressed by the Fifteenth Finance Commission leading to a reduction in the number of CSS to 28 Umbrella schemes, consisting of six Core of the Core, twenty Core and Optional schemes³⁰. The majority of these schemes follow a 60:40 funding ratio, where the Union government contributes the greater portion while in the case of North-Eastern States, the ratio is adjusted to 90:10, with the Union government contributing more significantly.

What must be kept in mind here is that CSS grants are grants which are constrictive in nature. These specific grants by the Parliament for the application of CSS don't leave any room for States to alter the program according to their need in that particular state. States have often asserted that even though CSS can help achieve a common national development goal but they are so rigid that the states are unable to amend it according to their own requirements in the state³¹. This becomes more of a hindrance when the schemes aim at making micro-level changes and that might not be suitable for every state³². Hence this means that the union government maintains considerable control of the detailed factors of implementation, limiting the flexibility of states and local administration to customize the implementation as per their respective unique circumstances. These are tied grants where the state does not have any type of volition in implementing the scheme. The top-down model, which enforces uniform policy from the centre, disregards the contextual complexities and specific needs of individual states

²⁷ Finance Commission of India, 15th Finance Commission Report (Oct. 2020)

²⁸ Anupama Kumar, *Centrally Sponsored Schemes and Centre-state Relations: A Comment*, DVARA RESEARCH, (Aug. 2020) [<https://dvararesearch.com/wp-content/uploads/2023/12/Centrally-Sponsored-Schemes-and-Centre-state-Relations-A-Comment.pdf>]

²⁹ Ministry of Finance, Govt. of India, Union Budget 2022-2023

³⁰ Finance Commission of India, 15th Finance Commission Report (October 2020)

³¹ NITI Ayog, Report of the Sub Group of Chief Ministers on the Rationalisation of Centrally Sponsored Schemes (2015)

³² Yamini Aiyar, *The Future of Centrally Sponsored Schemes (CSS) in the New Era of Devolution*, THE ACCOUNTABILITY INITIATIVE BLOG (Aug 19 2016) [<https://accountabilityindia.in/blog/5-the-future-of-centrally-sponsored-schemes-css-in-the-new-era-of-devolution/>]

and results in ineffective policy outcomes as it fails to take into account the specific problems encountered by each state.

The problem is multiplied by the fact that the federal fiscal structure is such that the states are dependent on the Union for funding their developmental schemes because the States are in a feeble state when it comes to economic position than the Centre³³.

Article 282 is dependent on the discretion of the Central Government³⁴. The power under Article 282 extends only to the funding of the programs in a state by the center, it has nothing to do with legislative powers. Hence, the grants under Article 282 are validated with only an Appropriation Act which will simply approve the expenditure depending on demand.³⁵ The volume of grants each year may vary from one year to another based on the priority of the Centre³⁶. As the centre doesn't have legislative competence in relation to subjects of the state list it cannot create any rights for the people through these schemes. Only the State is eligible to provide these rights as per Article 162³⁷, by implementing the schemes through executive orders. Thus Article 162 places restrictions on the Centre's power to work on subjects that are in the State's jurisdiction and Article 282 enables the Centre to provide grants for public purposes.

The extent to which states can execute CSS initiatives through executive orders, offering clearly outlined benefits to their residents, is dependent upon the federal grants they receive. In other words, the Union's use of its discretionary expenditure power, as given under Article 282 affects the States' authority under Article 162. Stated differently, it is evident from this that a person who does not obtain benefits from a plan runs the risk of having no legal remedy when the State has no remaining funds. The state's ability to create rights is subject to the condition of the Parliament's decision to release grants, which is discretionary in nature.

Concerns have been raised about the discretionary character of the transfers and deficiency of transparency in their formation. In particular, there are doubts regarding the lack of discussion

³³ INDIA CONSTI. art 248

³⁴ INDIA CONSTI. art 282

³⁵ INDIA CONST. arts 144,266

³⁶ The Budget Briefs by Accountability Initiative highlight changes in allocation and utilization of scheme funds from year to year. Accountability Initiative, Budget Briefs (2006 onwards)

³⁷ INDIA CONST. art 162

with states during the formation of many Centrally Sponsored Schemes (CSS). This insufficient consultation often leads to expenditure patterns that don't match with the priorities of the states.

Many also claim that Parliament often only makes schemes for short term instead of long term systematic overhaul. With newer schemes getting introduced frequently, the old schemes don't get followed through properly³⁸. These short-term schemes are generally framed keeping in mind the next elections and they keep changing according to the priority of the ruling party³⁹.

The criteria upon which grants are released is also not right⁴⁰. States are the deciding players in the implementation of CSS as it is they who implement it at the ground level which is also dependent on other factors like infrastructure, resources or other forms of unconditional grants, etc which determines the effectiveness of the program⁴¹. States are empowered to execute schemes utilizing their own financial resources or unconditional grants provided by the centre. Many of these schemes require state contributions for various components⁴². However, the Union's grant is not determined by the shortage of funds in the provision of services to the beneficiaries but rather the rise in expenditure as decided by the state itself⁴³. M. Govind Rao in a report to NITI Ayog has noted that state grants are calculated based solely on the previous year's state expenditure rather than on the actual costs required to deliver services⁴⁴. This along with delayed grant releases by the Union, often prevents the states from effectively utilizing the resources through the CSS⁴⁵.

The expansion of Centrally Sponsored Schemes over the years has led to a substantial decline in the capability of Indian States to meet their current expenditure out of their own revenues. Back in 1955-56, states were capable of financing approximately 69% of their current

³⁸ M. Govind Rao, "A Review of Indian Fiscal Federalism" in Report of the Commission on Centre-State Relations Supplementary Volume II: Research Studies

³⁹ Rajeshwari Deshpande et al., The BJP's Welfare Schemes: Did They Make a Difference in the 2019 Elections?, 7(2) STUDIES IN IND. POLT. (2019)

⁴⁰ Supra Note 26

⁴¹ Rajeshwari Deshpande et al., *States as Laboratories: The Politics of Social Welfare Policies in India*, 16 INDIA REV. 85 (2017); Louise Tillin et al., *Comparing the Politics of Food Subsidies in Chhattisgarh and Madhya Pradesh*, in POLITICS OF WELFARE: COMPARISONS ACROSS INDIAN STATES 102 (Louise Tillin et al. eds., 2015).

⁴² Chaturvedi Committee Report (n 39); Avani Kapur, *Centre Gives a Lot of Money to States for Social Welfare. A Good Policy, But Only on Paper*, THE PRINT (June 25, 2019),

⁴³ Govind Rao, Central Transfers to States in India: Rewarding Performance While Ensuring Equity: Report submitted to NITI Ayog (2017)

⁴⁴ *ibid*

⁴⁵ Accountability Initiatives, 'Centrally Sponsored Schemes: An Instrument for Financing Development' (30 August 2019) Presentation Made at the Centre for Policy Research, New Delhi

expenditure independently, however, this proportion has fallen to less than 38% by 2019-20⁴⁶. Although the budget allocation for CSS has surged dramatically by around 90% from 2,31,900 crores in 2016-17 to Rs 4,42,781 crores in 2022-2⁴⁷.

The rising expenditure on Centrally Sponsored Schemes has compelled state governments to shape their expenditure priorities by these CSSs, limiting their ability to fund their own requirements independently⁴⁸. Additionally, the CSS framework, marked by its one-size-fits-all approach, presumes all states face identical circumstances at the policy level, overlooking each state's distinct individual requirements. Yet states lack participation in policy formulation, which may not suit their specific contexts. State governments possess superior knowledge of local conditions, cultural factors, and demographic patterns, all of which critically shape policy effectiveness. Research has also shown that decentralization of policy decisions leads to higher accountability of local representatives which boosts the performance and effectiveness of public service delivery to citizens⁴⁹.

Conclusion

National-level policies such as Centrally Sponsored Schemes (CSS) can play a pivotal role in achieving key national objectives while also taking into account the fiscal health and conditions of state governments. Well-framed policies at the central level have the potential to elevate the fiscal situation of states by making sure that the grants provided are utilized properly, leading to an enhancement of the country's social condition. While it is true that top-down policies like CSS usually impose the policy preferences of the central government on the state level, when appropriately designed, they can still preserve state autonomy by involving state levels of government in the implementation process. This will allow a balance to be struck between national goals and vision on one hand, and state independence and local requirements on the other. The excessive centralization in the current social policy framework has undermined the fiscal autonomy of states, necessitating structural adjustments in inter-governmental structures. To ensure the proper working of national schemes like CSS, a collaborative approach among all levels of government is required.

⁴⁶ Kalaiyarasan A, *The poor State of India's Fiscal Federalism*, THE HINDU (July 08 2022)

⁴⁷ Supra Note 26

⁴⁸ Supra Note 26

⁴⁹ *ibid*