



Federalism and Fiscal Autonomy: Centre-State Relations in the Indian Constitution

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Published: 18/04/2025

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How to Cite this Article:

Mahajan, P. (2025). Federalism and Fiscal Autonomy: Centre-State Relations in the Indian Constitution. *Indian Journal of Law*, 3(2), 12-16.

DOI: <https://doi.org/10.36676/ijl.v3.i2.84>

Abstract

Federalism is a cornerstone of India's constitutional structure, with power distributed between the Centre and the States. However, Indian federalism reflects a strong unitary bias, especially in fiscal matters. This paper explores the conceptual framework of federalism and fiscal autonomy in India, examines constitutional provisions governing the distribution of financial powers, and evaluates the role of institutions like the Finance Commission and GST Council. It further analyses key judicial decisions and political developments that have shaped Centre-State fiscal relations. By reviewing contemporary challenges, including issues arising from the Goods and Services Tax (GST) and COVID-19 pandemic, the paper highlights the need for cooperative federalism and greater fiscal decentralization to strengthen India's democratic framework.

Keywords: Federalism, Fiscal Autonomy, Indian Constitution, Finance Commission, GST Council, Centre-State Relations, Fiscal Federalism.

Introduction

Federalism, in essence, is a system of governance in which power is constitutionally divided between a central authority and constituent units, such as states or provinces. India, though not a classical federation like the United States, adopts a quasi-federal structure. The Indian Constitution, through Articles 245 to 263 and the Seventh Schedule, outlines the legislative, administrative, and financial relationships between the Union and the States.

A crucial aspect of this relationship is fiscal federalism—the allocation of taxation and expenditure powers. While the Indian Constitution provides a detailed framework for financial distribution, it tends to favour the Centre, thus impacting the autonomy of states in raising and spending funds. This paper investigates the evolution, structure, and current dynamics of Centre-State fiscal relations in India, with a special focus on constitutional mechanisms and recent developments such as GST and emergency financial measures during the COVID-19 crisis.





Conceptual Framework: Federalism and Fiscal Autonomy

Federalism: Theoretical Foundations

Federalism is characterized by the division of powers and responsibilities among levels of government. It is designed to accommodate diversity, ensure local governance, and promote accountability. Classical federal systems exhibit dual sovereignty and coordinate status for central and regional governments.

Fiscal Autonomy

Fiscal autonomy refers to the ability of sub-national governments to manage their own revenues and expenditures. It encompasses:

Revenue Autonomy: Control over tax bases and rates.

Expenditure Autonomy: Power to allocate funds according to regional priorities.

Borrowing Autonomy: Freedom to borrow without central restrictions.

Constitutional Provisions on Centre-State Fiscal Relations

Division of Powers (Seventh Schedule)

The Indian Constitution delineates functions and financial powers through three lists:

Union List (List I): Includes income tax, customs, excise (except on alcohol), and corporation tax.

State List (List II): Includes taxes on agricultural income, land, and excise on alcohol.

Concurrent List (List III): Subjects such as education and forests, where both Centre and States can legislate.

Article 268 to 293: Fiscal Provisions

Article 268-269: Distribution of taxes collected by the Centre but assigned to states.

Article 270: Central taxes shared with states based on the recommendations of the Finance Commission.

Article 280: Establishes the Finance Commission to recommend the distribution of net proceeds.

Article 275: Provides for grants-in-aid from the Centre to States.

Article 293: Restricts States' borrowing powers without Centre's consent.

Institutions Governing Fiscal Federalism

Finance Commission

Established under Article 280, the Finance Commission recommends:

Distribution of tax revenues between Centre and States.

Grants-in-aid.

Measures to augment state revenues.

The 15th Finance Commission (2020–2025) increased the states' share in central taxes to 41%, though states criticized reductions in grants.

GST Council





The Goods and Services Tax (GST) was introduced through the 101st Constitutional Amendment in 2016, replacing multiple indirect taxes. The GST Council, under Article 279A, comprises Union and State representatives and makes recommendations on GST rates and exemptions.

While GST promotes uniformity, it has reduced state autonomy over indirect tax revenues, making them more dependent on compensation from the Centre.

Challenges to Fiscal Autonomy

Vertical Fiscal Imbalance

India's revenue system is highly centralized. While the Centre collects the bulk of taxes, the States bear the brunt of social expenditure (health, education, agriculture). This leads to a vertical fiscal imbalance, often addressed through transfers, grants, and borrowing.

Delay in GST Compensation

States were promised compensation for revenue shortfall for five years after GST's implementation. However, during the COVID-19 pandemic, the Centre failed to meet this obligation fully, citing "Act of God," triggering debates about trust and equity in federal relations.

Centrally Sponsored Schemes (CSS)

A large portion of state budgets is tied up in centrally sponsored schemes, which restricts States' flexibility to plan and implement programs tailored to their needs.

Political Centralization

With rising centralization of power—both politically and economically—States often find themselves constrained, especially those ruled by opposition parties. The use of agencies like the CBI, ED, and NIA also affects the spirit of cooperative federalism.

Judicial Interpretation and Federal Balance

State of West Bengal v. Union of India (1963)

The Court held that the Centre could legislate on any subject within its domain, even if a state opposes it. This underscored the unitary tilt in India's federal structure.

S.R. Bommai v. Union of India (1994)

The Supreme Court recognized the importance of federalism as a basic feature of the Constitution, providing checks against arbitrary imposition of President's Rule.

Subramanian Swamy v. Union of India (2016)

The Court emphasized cooperative federalism as the bedrock of GST, stating that state participation in GST Council ensures accountability and balance.

Recent Developments and the Way Forward

COVID-19 and Fiscal Strain

The pandemic tested federalism severely. While States were responsible for managing health and containment, they lacked adequate resources and autonomy. Delays in GST compensation and borrowing restrictions exacerbated fiscal stress.





NITI Aayog and Planning Post-2015

With the abolition of the Planning Commission, the role of NITI Aayog as a policy think tank is less authoritative in resource allocation. However, its cooperative approach seeks to strengthen federal dialogue.

Need for Fiscal Empowerment of Local Bodies

True fiscal federalism must extend beyond states to Panchayats and Urban Local Bodies, as envisaged under the 73rd and 74th Amendments. Empowering grassroots institutions can improve public service delivery.

Comparative Federalism: Lessons from Abroad

United States

States in the U.S. have broad powers to tax and spend. There is no centralized tax like the GST. This allows significant fiscal autonomy but also greater fiscal disparities.

Canada

The Canadian system includes equalization payments and grants to poorer provinces to address regional disparities while allowing provinces autonomy in health and education.

The Commonwealth Government controls most revenues, but the Commonwealth Grants Commission ensures equitable distribution. Australia's Council of Australian Governments (COAG) functions like the Indian GST Council.

Recommendations

Reform GST Compensation Mechanism: Make compensation payments automatic, predictable, and timely.

Strengthen the Finance Commission: Institutionalize periodic assessments and widen its scope to include borrowing limits and local body funding.

Reduce Tied Grants: Allow more untied transfers to states to promote flexibility and innovation.

Constitutional Amendments: Consider revising Articles related to borrowing and emergency powers to enhance state autonomy.

Promote Intergovernmental Dialogue: Encourage regular meetings between state finance ministers, NITI Aayog, and the Centre for coordinated fiscal planning.

Conclusion

India's federal structure, while unique and flexible, leans heavily towards the Centre, especially in fiscal matters. Despite constitutional safeguards and mechanisms like the Finance Commission, fiscal autonomy of the states remains constrained. The GST regime, while promoting tax uniformity, has diminished state-level flexibility and increased dependency on the Centre.

Strengthening cooperative federalism, enhancing fiscal transparency, and empowering state and local governments are critical for sustaining India's unity in diversity. Federalism must not only





be a structural feature but a living principle of governance that respects regional aspirations, enables financial independence, and fosters collaborative policy-making.

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