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The centralization vs decentralization tug of war and the emerging narrative of fiscal federalism for social policy in India

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ABSTRACT

This paper examines the relationship between fiscal federalism and social policy in India through an analysis of the effects of a recent effort to increase fiscal decentralization to state governments on the nature of social policy investment at the sub-national level. Through its analysis, this paper highlights the persistence of a strong centralisation bias in India's fiscal architecture for social policy. We trace this centralisation bias to the political and administrative dynamics of the federal bargain. The peculiar dynamics of this bargain have created a context where the core goal of centralization – to ensure equity – is undermined while the expectation of decentralization – greater accountability through alignment of expenditure with local needs and preferences, fails to take root. India is thus likely to continue to witness significant regional variation in social policy outcomes, despite a centralised financing architecture.

KEYWORDS Social policy; India; federalism; decentralisation; health; education

Introduction

In February 2015, India embarked on a new path toward decentralizing its fiscal architecture. The Government of India (GoI) accepted the recommendations of the Fourteenth Finance Commission (FFC) to enhance sub-national (state) governments' share in the divisible pool of taxes¹ by 10 percentage points. The stated objective of this recommendation was to strengthen fiscal decentralization to states. This reform was accompanied by several changes in the mode of planning and design of inter-governmental fiscal transfers to states. In January 2015, the government dismantled the Planning Commission (India's premier national institute mandated to formulate central plans for national development) to set up the NITI Aayog. The NITI Aayog is mandated to move the country away from centralised planning and

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financing for development and instead, create a platform to 'bring states to act together in national interest and thereby foster Cooperative Federalism'.² One of the Aayog's first tasks was to develop a set of recommendations to restructure the design of specific purpose transfers (known as Centrally Sponsored Schemes) from the Union government to states. These Centrally Sponsored Schemes (CSSs) are the primary vehicle through which the Union government finances and controls social policy spending in India.

These reforms unfolded against the backdrop of a political call by the newly elected National Democratic Alliance (NDA) government with Prime Minister Narendra Modi at its head, to strengthen 'cooperative' and 'competitive' federalism in India. In several public statements after taking office in 2014, the Prime Minister had repeatedly stressed the pivotal role of State governments as 'drivers of transforming India' appealing to states to 'imbibe the spirit' of cooperative federalism.³ Thus in rhetoric and in action, India in 2015, was firmly on the path towards putting in place a new decentralised fiscal architecture.

This effort to enhance fiscal devolution to sub-national governments and promote 'co-operative federalism' provides fertile ground to investigate a key concern in debates on fiscal decentralisation: the potential trade-offs between expenditure efficiency and local accountability through greater decentralization on the one hand and regional variation in social outcomes on the other. Through an extensive review of state and union government budget and planning documents this paper seeks to contribute to current empirical understandings of these trade-offs by investigating the effects of greater fiscal devolution on social policy investments in India. It is important at the outset to state that our analysis of the impact of the FFC is at best preliminary. At the time of writing this paper, the only reliable budget data available that allowed for a comparison of expenditure behaviour was for the two financial years: 2014–15 (before the implementation of the FFC) and 2015–16. Thus, rather than offering a definitive account of the impact of the FFC on social policy expenditure, our analysis presents a preliminary descriptive account of emerging trends and the unfolding dynamics in the fiscal federal bargain.

Much of the current literature on the relationship between fiscal federalism and social policy outcomes focuses on the design of the intergovernmental fiscal system, specifically the division of taxes and expenditure responsibilities, as the primary explanatory variable for understanding variation in regional outcomes (see Acosta and Tillin, forthcoming for a comprehensive summary of the literature). Another robust strand of literature emphasizes the role of sub-national politics as a key factor (Aiyar and Walton 2015; Priyam 2015; Tillin 2017) in shaping welfare outcomes in decentralized settings.

Our review of the unfolding Indian experience adds an important and relatively understudied dimension to this literature— the interplay between levels

of political and administrative (de)centralization on the dynamics of the inter-governmental fiscal bargain. We argue that the dynamics of this bargain is a critical variable that shapes the relationship between fiscal decentralisation and welfare outcomes. In the specific context of India, our review highlights a deep paradox in the federal arrangement, an increasingly decentralized politics co-existing with a political and bureaucratic consensus that favours a deeply centralized fiscal architecture. The resultant pulls and pressures of these two contradictory dynamics is the primary factor shaping the current state government response to changes to the new fiscal arrangement and consequent impact this may have on social policy expenditure.

The primary contribution of this paper lies in going beyond fiscal design considerations to bring together literature on political and administrative decentralization with analysis of sub-national expenditure patterns to understand the implications of greater fiscal decentralization on social policy investments and outcomes.

Fiscal federalism and social policy in India: A brief overview

India's federal architecture is widely recognized for having several centralizing features embedded within it. Scholars have described India's federalism as 'quasi federal' or 'holding together federalism' (Stepan 1999; Wheare 1964). This centralized federalism is particularly visible in the constitutionally mandated fiscal federal framework. The delegation of fiscal powers and responsibilities specified in the constitution reflects what Rao and Singh (2005) have characterized as a 'centripetal bias with the Centre having "overwhelming and overriding" economic powers'. This includes the assignment of all major broad-based taxes and the powers to impose restrictions on state government borrowing. State governments, on the other hand, have primary expenditure responsibility for the provision of core public services – public health, agriculture, land rights and so on. Crucially, the constitution identifies several expenditure functions that are 'concurrent' or shared by the centre and state. For concurrent expenditures, the centre has overriding veto powers in case of a conflict with states on matters related to the concurrent list thereby deepening centralization.

To address the inevitable vertical imbalance emerging from the assignment of taxation powers and expenditure responsibilities, the constitution provides for the creation of an independent Finance Commission (FC) appointed by the President every five years. The Commission is responsible for determining the share of tax devolution and grants in aid to state governments. The FC, as Srinivasan and Wallack (2011) argue, was explicitly designed to preserve State governments' autonomy in designing their budgets.

In 1950, the Government of India (GoI), through a cabinet resolution set up the Planning Commission (PC). The PC's primary mandate was to develop

national plans. The PC was not explicitly mandated to play a role in financing plans and determining inter-governmental fiscal transfers. However, over time, it took over the responsibility of determining the size and quantum of 'plan' grants (financial assistance given to states to implement the Five-Year plans prepared by the PC). Two consequences emerged from this. First, the FCs role in terms of fiscal transfers for social policy became increasingly limited. De facto, the FC restricted its determination of inter-governmental transfers to non-plan funds while the PC took on the responsibility of determining plan allocations which related specifically to areas of social policy. Second, the PC began to use its powers to encroach into planning for and financing expenditures that were constitutionally in the state's domain (Rao and Singh 2005; Srinivasan and Wallack 2011) thereby deepening centralization of the fiscal federal framework.

The centralized character of India's brand of federalism was, as many scholars have argued, perhaps necessary given the particular political context – the partition in 1947 and the need to bring states together to participate in the project of nation-building. This 'federalist compromise' (Tillin 2017) has played a critical role in ensuring independent India's democratic consolidation. However, the dynamics of the federal bargain have evolved significantly since the constitution was adopted in 1950. As observers of India have noted, in the decades following independence, India's polity has undergone several important transformations. From the perspective of the federal bargain, two critical changes stand out. First, the evolution of India's polity from single party dominance to a multi-party dominance with regional political parties, particularly from the 1990s onward playing a significant role in shaping national politics. Second, the shift in policy toward economic liberalization that necessitated a move away from centralized planning toward greater economic autonomy for state governments. These shifts in India's political and economic landscape set the stage for a new phase in India's federalism (Mitra and Pehl 2010; Saez 2002; Singh and Verney 2003), with states claiming greater autonomy and attempting to renegotiate the dynamics of centre-state relations.

Specifically, from the perspective of social policy, the increased regionalization of India's politics created a new dynamic where state politics began to proactively shape social policy outcomes. As many scholars have highlighted, state politics have, in this phase of India's federal evolution, emerged as important drivers for innovation and change (Aiyar and Walton 2015; Deshpande, Kailash, and Tillin 2017; Priyam 2015).

Despite this significant shift toward greater state autonomy in political, economic and social policy spheres, the overall centralized nature of India's fiscal architecture persisted (Srinivasan and Wallack 2011). In fact, the last decade saw a significant expansion in India's financial investments in social policy. The bulk of this investment took place through specific-purpose

transfers or CSSs financed and monitored through the Planning Commission's plan funds (see next section for a brief discussion on CSS), making CSSs one of the most important vehicles of central transfers to states. To illustrate, during the 11th Five Year Plan (2007–2011), scheme specific transfers accounted for over 40% of central transfers to states (Chaturvedi 2011). Many of these schemes covered subjects constitutionally assigned to state governments. Between 2005 and 2012, the Central government spending on State subjects increased from 14 to 20 per cent and its spending on Concurrent Subjects increased from 13 to 17 per cent (calculations by FFC in Rao 2017)

CSS and central government encroachment on state subjects have been a repeated source of tension between the centre and states. However, until the FFC recommendations, this tension had not resulted in any change in India's fiscal architecture. Rather than decentralizing, as the data above highlights, India became far more centralized in its financing for social policy even as politics and the economy became more decentralized. Interestingly, although the issue of India's centralised fiscal architecture has featured in several scholarly debates on fiscal federalism relations, the puzzle of the persistence of a centralised fiscal architecture coexisting with a relatively decentralised political and economic system has received scant attention. Srinivasan and Wallack (2011) attempt to unpack this puzzle in their paper by arguing that India's economic and political structures have impeded collective action by states, making it difficult to bring fiscal concerns into the political federal bargain. But this is likely the only analysis of its kind. Importantly, this paper took for granted the basic design principle that greater decentralization has a positive impact on social policy by aligning expenditure with local preferences and ensuring local accountability for expenditure decisions. Thus, it does not extend its analysis to understanding the effects of the centralizing/decentralizing dynamic on social policy investment choices and ultimate outcomes.

It is against this backdrop that the Gol's recent efforts to restructure the fiscal architecture by adopting the recommendations of the FFC report, dismantling the Planning Commission and restructuring the CSS need to be understood. Given this context these steps marked a radical shift in fiscal federalism. For social policy the importance of these shifts was two-fold. First, the enhanced tax devolution to states served to re-assert the centrality of states in planning and financing the delivery of core public services, as envisaged by the Constitution. In fact, this was the stated goal of the FFCs recommendation. Second, the concomitant move to dismantle the Planning Commission and restructure CSSs suggested the centre's willingness to cede control over core schemes and empower states to design and implement social sector schemes. Given the dominant role the CSS have come to play in social sector schemes this was a significant step in the direction of deepening fiscal federalism in India.

The importance of centrally sponsored schemes to social policy financing

CSS play a critical role in social policy financing and have been at the centre of the debate on fiscal decentralization for social policy in India. Against this backdrop and to understand the context in which the effects of the FFC recommendations ought to be evaluated, it is important to unpack the precise role that CSS have played in financing social policy. In principle, the rationale for CSSs – equalization to ensure that minimum standards of public services are provided to all citizens – is sound and in keeping with first principles. However, the design, practice and consequent proliferation of CSSs has undermined this rationale, serving instead to promote a deeply centralized intergovernmental transfer system.

The practice of providing sector specific transfers from the Union to States dates back to the pre-independence era when the British government introduced post-World War II development grants to states. The first Five-Year Plan continued with this tradition of sector specific central transfers and by the launch of the third Five -Year Plan in 1961, there were 92 sector specific schemes (or CSSs) sponsored by Centre. The proliferation of CSSs was an important red flag even in the early phase of centralised planning. In the 1969 meeting of the National Development Council,⁴ a recommendation was made to cap the value of CSSs to 1/6th of the Central Plan assistance to States. However, this was not implemented and by the sixth Five-Year Plan as much as 35% of planned central assistance to states was provided through CSS (Chaturvedi 2011). Through the 1990s and onward, CSS grew significantly, both in size and quantum. By 2005, the number of schemes had grown to 225. The end of every Five-Year Plan invariably led to the disbanding and transfer of schemes to states. But these efforts yielded only temporary results. On the eve of the adoption of the recommendations of the FFC recommendations, there were still 66 CSSs, accounting for 44% of central assistance to states (2014–15 BE), financing all the major social policy programmes of the time (Niti Aayog 2015).

For social policy, the relative importance of the CSSs as an instrument of fiscal transfers lies in the fact that they are the primary source of non-wage, uncommitted funds available to states. As CSS grew in size, State governments began to spend less on their own state schemes. Analysis undertaken on trends in State expenditures in health and education between 1950–2007 by Rajaraman (2007–08) demonstrates this very effectively. Constitutionally, health is exclusively in the domain of state governments' while education is on the concurrent list (since 1976). Consequently, the expectation is that the bulk of expenditures in these two areas ought to be made by the state. Rajaraman's analysis found that the share of state budgets in expenditures on health and education was at or above 90 percent for the bulk of this

period. However, since 2000 (when central government spending through CSS began to increase), state expenditure saw a sharp fall settling at about 85%. This fall in state share coincided with a slight increase in overall expenditure. Rao and Choudhury (2012) undertake a similar analysis for health expenditure to find that increases in central government expenditure in health led to substitution of health expenditure by states with central government expenditure. The substitution effect is higher in the period 2001–02–2007–08. It is important to note that this fall in expenditure coincided with the introduction of a number of measures aimed at disciplining state government expenditure such as the passage of the Fiscal Responsibility and Budget Management Act in 2003. To a degree, the expansion of central schemes in social sectors, such as the CSS for elementary education - the Sarva Shiksha Abhiyan (SSA), or the CSS for health – the National Rural Health Mission (NRHM) created perverse incentives for states to reduce spending in these areas amidst fiscal tightening (Rao and Choudhury 2012).

Equally important, is the particular kind of expenditure that the CSS were substituting. By the late 2000s, state governments increasingly drew on CSS for all non-wage related expenditure in these sectors. The bulk (between 80%–90% in some states) of state resources were being used for salaries and other fixed costs. This is evident from Tables 1 and 2 which show the relative share of salaries and other wage liabilities to the total state expenditure

Table 1. State-wise expenditure on human resources as a percentage of total state Government expenditure on Health, 2013–14.

| Name of the State | Proportion of total state expenditure on health going for Salaries, wages and other employee related costs (%) |
|------------------------------------|--|
| Andhra Pradesh (Undivided/ United) | 81.2 |
| Assam | 48.3 |
| Bihar | 60.6 |
| Chhattisgarh | 85.3 |
| Gujarat | 54.3 |
| Haryana | 89.4 |
| Himachal Pradesh | 79.7 |
| Jammu and Kashmir | 87.1 |
| Jharkhand | 76.9 |
| Karnataka | 64.4 |
| Kerala | 87.8 |
| Madhya Pradesh | 79 |
| Maharashtra | 87.4 |
| Mizoram | 85.5 |
| Nagaland | 93.5 |
| Odisha | 66.7 |
| Punjab | 92.4 |
| Rajasthan | 79.3 |
| Tamil Nadu | 70.4 |
| Tripura | 60.8 |
| Uttar Pradesh | 64.4 |
| West Bengal | 74.8 |

Source: Lok Sabha, Unstarred Question, 1840, Answered on 25th November 2016.

Table 2. Expenditure on teacher salaries out of total budget for school education (elementary and secondary) in 2015–16.

| Name of the State | Salary proportions in School education (elementary and secondary) in 2015–16 |
|-------------------|--|
| Bihar | 51.6 |
| Jharkhand | 54 |
| Odisha | 54 |
| Chhattisgarh | 60.8 |
| Madhya Pradesh | 63.7 |
| Tamil Nadu | 67 |
| Maharashtra | 68.8 |
| Karnataka | 71.6 |
| Uttar Pradesh | 74.5 |
| Rajasthan | 80.4 |

Source: CBGA (2016).

on two major social policy programmes: health and education. In addition to their prominent role in spending, CSSs also became an important focal point through which central government directed and controlled social policy expenditure at the state level.

From a political perspective, CSS became an important political tool through which to dispense patronage and promote spending. This has been highlighted through a robust body of analytical work (Dasgupta, Dhillon, and Dutta 2004; Khemani 2007; Nayak, Saxena, and Farrington 2002; Rao and Singh 2003; Singh and Vasishtha 2004; Srivastava 2005). In their analysis, Nayak, Saxena, and Farrington (2002) trace the proliferation of CSS to Indira Gandhi's electoral strategy in the 1970s which led to the launch of a number of anti-poverty programmes by the Centre. The CSSs were not usually formula based giving individual ministries significant discretion in determining state specific allocations. Consequently, CSSs served two important political purposes. One, to allow the Union government to respond to state specific politics by allocating a larger quantum of funds to states where electoral calculations demanded it. Second, to provide political parties at the centre visibility in states. It is instructive that the United Progressive Alliance (UPA), which is widely credited for having pursued the country's most ambitious social policy agenda, did so through the CSS route.

However, even as the centre saw CSS as a tool to dispense patronage and seek political visibility in states, the regionalisation of India's politics particularly from the late 1990s onward created a new dynamic where state political parties became deft at drawing on CSS to their electoral advantage, claiming credit when successful (Tillin and Pereira 2017) and blaming the central government for failures (Aiyar 2018). In fact, CSSs have often been an important political bargaining tool. One illustration of this is over the renaming of the UPA government's flagship National Rural Employment Guarantee Act (NREGA) launched in 2006 to the Mahatma Gandhi National Rural Employment Guarantee Act in 2009. This renaming was initiated to prevent

non-Congress ruled states from staking claim and gaining political mileage for MGNREGA. In public statements, prior to the renaming, Congress leaders very clearly said they 'would not allow NDA ruled states to rename flagship schemes for their political gains' (Chaudhuri, Aiyar, and Wallack 2009. See also Tillin and Pereira 2017).

While the political dynamics and consequent centralization vs decentralization tussle in CSS is well documented, a relatively less studied, yet crucial aspect of the centralization process is the role of bureaucratic discretion in shaping expenditure and implementation decisions at the sub-national level.

Most CSSs are designed as a cost-sharing programme. In this arrangement, States are responsible for contributing anywhere between 10%–50% of the total cost of the scheme from their own plan funds. However, the centre determines the allocation of resources and thus reserves the power to determine the scheme design and approve state specific plans and budgets. In many instances, including health and education, central and state shares are transferred to specially created societies that exist outside of the state government line department system creating even greater opportunities for bureaucrats to exercise control (Ministry of Health and Family Welfare 2013; Ministry of Human Resource Development 2011). Moreover, these schemes are designed to promote their own planning process at the sub-national level (state, district and village level) that are divorced from the state budget linked planning process and have little connection with the state line ministry (Aiyar, Chaudhuri, and Wallack 2010).

CSS budgets are determined annually on the basis of plans submitted by state governments to the line ministries in Gol. A close reading of the Plan and budget documents highlights the degree to which bureaucrats in the central government's line departments influence the final budgets at the state level. This has as Sanan (2014) argues, cast bureaucrats in the Union government line ministries in a hierarchical relationship where state governments act as mere implementing agents responding to rules and orders issued from the centre. So much so that even granular implementation details – communication strategies, hiring processes and schedules of activities are laid down by the centre. This has given the central government the power to withhold fund releases to state governments if conditionalities are not met, leading to a lot of unpredictability in the movement of money.⁵

To illustrate the particular dynamics of the centre-state relationship in CSSs and highlight the degree of central bias, below is a sample of a few discussions recorded in the annual Planning and Budget Meeting (PAB) minutes from two different years for Sarva Shiksha Abhiyan (SSA), Gols flagship elementary education CSS (Aiyar et al. 2015).

- In 2013–14, one state government wanted to use the SSA budget to provide vehicles for block level officials to improve school level monitoring.

The Board denied this request as purchase of vehicles was not permitted under SSA rules.

- In the 2011–12, another state government requested a top-up grant to improve the quality of their textbooks. The Board however only had funds for the purchase of text books and asked the State to create a competitive bidding process to print books to be able to save money for additional activities if they needed the grants to improve textbook quality.

A similar story holds true for health. In their report on the planning and budgeting system of the National Health Mission (NHM) in Bihar and Uttar Pradesh, *Accountability Initiative (2018)* finds that the Central priorities frequently override attempts at independent planning by states. They report,

A clear example of this is the three-year perspective plan that was created under NHM for the period FY 2014–17. This plan was meant to detail activity-wise targets and create a detailed results-based framework to track outputs and outcomes. However, changing Gol priorities and directives issued have rendered the plan redundant

As we have illustrated through this discussion, CSSs have allowed the Union government through political and bureaucratic bargaining, to assume responsibility and dictate implementation for all critical social policy programmes. States have repeatedly raised concerns over the proliferation of CSSs, arguing that they infringe on their autonomy by reducing their fiscal space and their ability to meet their specific development needs. States have also complained against the central government's interference in the nuts and bolts of implementation with its uniform norms and tightly controlled planning and budgeting process (Chaturvedi 2011). It is against this background of deep centralization, limited capacity for state governments to direct expenditure according to their own needs and priorities even at the granular level of budget line items within schemes and increased political salience of CSS as an electorally relevant instrument for promoting welfare that the FFC recommendations to enhance tax devolution to state governments gained significance.

The Fourteenth Finance Commission and social policy investments

In its 2015 report, the FFC sought to make three critical changes to the existing Intergovernmental Fiscal Transfer system (IGFT). First, in accordance with its constitutional mandate to share the proceeds of centrally levied taxes with the States, the FFC enhanced the State's share of the divisible pool of taxes from 32 per cent to 42 per cent. Second, FCs are empowered to provide tied grants in aid to states. The FFC, in a departure from the practice of providing sector specific conditional grants-in-aid,⁶ sought to provide

unconditional grants in three broad areas – disaster management, grants to local bodies and revenue deficit grants. Third, the FFC broke from past convention of restricting FFC recommendations to tax devolution and non-plan grants-in-aid to take a comprehensive view on *all* (including plan) funds to determine the revenue share between the centre and states. It was thus able to also recommend reforms in the design and implementation of CSS. Rather than make specific recommendations, the FFC argued for reforms in CSS '*with a view to minimising discretion, improving the design of transfers, avoiding duplication and promoting cooperative federalism*' (Finance Commission 2015).

To what extent have these recommendations been implemented and has the increased flexibility to states through enhanced devolution resulted in significant changes in state investments in social sectors? To answer this question, it is important to understand the actual impact of the FFC on social policy investments at the state level. We do this through a detailed study of individual state finances across two years. Thus, we compare actual expenditure in 2014–15 (the year preceding the implementation of the FFC with 2015–16 (after the implementation of the FFC).

Before presenting our findings, it is important to highlight our methodology and associated constraints. India follows an annual budget cycle broken into three phases. The first phase begins on the 1st of April when allocations to line department are made by the Ministry of Finance (MoF). These allocations are referred to as Budget estimates (BEs). The second phase begins in October when line ministries revisit their budgetary allocations based on fiscal performance and estimate actual expenditure undertaken through the year. These are known as Revised Estimates (REs). Finally, the actual expenditure (Actuals) incurred is computed with a two-year lag following a detailed auditing process by the Comptroller Auditor General (CAG) of India. There are often wide gaps between BEs, REs and Actuals.

Thus, in order to obtain the most realistic estimate of the actual impact of the FFC, we compare actual expenditure in 2014–15 (the year preceding the implementation of the FFC with 2015–16 (after the implementation of the FFC). Our analysis is restricted to using 2014–15 as the base year due to changes in mechanisms of fiscal transfers and associated budget changes. Till 2014, funds for many CSSs (amounting to Rs. 1,12,708 crore (USD 16575 million) in 2013–14) were transferred directly to implementing agencies, bypassing state budgets. This was changed in 2014 and all funds are first routed through state budgets. The changes in budget flows have not been adjusted in past budget documents making it difficult to compare budgets post 2014 with earlier years.

Data for this analysis has been sourced from two main documents. Information on total central transfers and social sector expenditures pertaining to 21 states has been taken from individual state budget documents. In

order to get a disaggregation of the type of central transfers, information has been drawn from state finance accounts compiled by the Auditor General of India. Finally, in order to ensure our estimates are benchmarked we have analysed changes in transfers and social sector expenditures as a proportion of the state's Gross State Domestic Product (GSDP).

Our analysis focuses on three indicators: (a) quantum of fiscal transfers (b) changes in the composition of fiscal transfers (to measure the degree of flexibility in funds available to states) and (c) changes in the social sector expenditures as a proportion of GSDP.

Implementing the FFC recommendations

Change in net resources

The first steps toward implementing the FFC reforms were taken in the 2015 budget when the Union Government increased tax devolution to states from Rs. 3.37 lakh crores (USD 49.6 billion) in 2014–15 (actuals) to Rs. 5.06 lakh crores (USD 74.4 billion) in 2015–16 (actuals) (Government of India 2015, 2016, 2017). As a proportion of GDP, tax devolution increased from 2.7% to 3.7%.

To accommodate this increase, given the limited fiscal space available with the Union government, the devolution was accompanied by a reduction in conditional grants to states, particularly a cut in CSSs.⁷ Central assistance to state plans including for CSSs, decreased from Rs. 2.64 lakh crore (USD 38.8 billion) in 2014–15 to Rs. 2.03 lakh crore (USD 29.9 billion) in 2015–16.

Despite this decrease in grants, analysis of the aggregate net transfers (devolution and grants) from the Union to states increased, albeit marginally, from 5.4% of GDP in 2014–15 to 6.1% in 2015–16.

Composition of transfers

While the overall increase was modest, it is important to remember that the intention of the FFC was not to increase the overall funds transferred to states, but instead to change the composition of central transfers. With an increase in the share of taxes devolved, it was expected that there would be an increase in unconditional (untied) transfers to states and simultaneously, a reduction in the share of central transfers going for conditional transfers (or tied funds).

Analysis of the Union Budget shows that overall, as expected, out of the total transfers from the Centre to States, the share of untied transfers⁸ increased from 63% to 71% while the proportion of conditional tied transfers (primarily through scheme grants) decreased from 36% to 29% between 2014–15 and 2015–16 (Government of India 2016, 2017).

This change in the mode of transfers is also reflected in State budgets. Our analysis of state budgets suggests that as expected, most states did see a

reduction in tied transfers as a proportion of their GSDP (see [Figure 1](#)). For some, such as Himachal Pradesh and Assam, the reduction was significant leading to a relatively higher share of untied funds (tax devolved and non-plan FC grants) from the Union.

It can be argued that a year on year comparison may not provide an accurate picture if tied transfers in 2014–15 (the base year for measuring change) are unusually high or low. In order to test this hypothesis, Choudhury, Mohanty, and Dubey (2018), compared the 2015–16 share of plan transfers as a proportion of GSDP with the average share of plan transfers during the Thirteenth FC period (2011–2015).⁹ Their analysis found that even after increasing the number of years, the decline in plan transfers is significant. Their analysis finds that overall the decline in transfers in 2015–16 was high even when compared with aggregate transfers over a 4 year period (2011–2015).

Importantly, the change in composition of transfers is not as stark as expected. The primary reason for this is that the overall CSS fund architecture remained largely unchanged (discussed in detail in the next section). In 2015–16, CSS funds were increased (despite cuts in the initial budget) through supplementary budgets. In aggregate, CSSs and other conditional schemes categorised as Central Assistance to State plans increased by over Rs. 11,000 crores (USD 1617 million) from Rs. 1.96 lakh crore (USD 28.8 billion) to Rs. 2.08 lakh crore (USD 30.6 billion) between the initial budget estimates in 2015–16 and the revised estimates for 2015–16.

Social sector expenditures

The previous section establishes that state governments' in aggregate, did have access to greater untied resources in 2015–16. The key question for

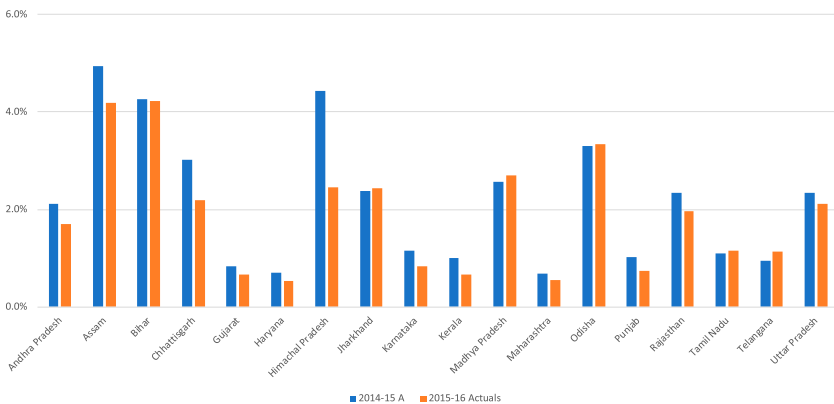


Figure 1. Receipts of Tied Plan grants to states (as a % of GSDP). Source: Authors calculations based on data collated from finance accounts of states (Comptroller and Auditor General of India 2015 and 2016).

this paper is whether this change in structure influenced overall social sector expenditures at the sub-national level.

As already mentioned, central transfers through CSSs had become an important instrument of financing social sector by the Union government. Analysis of 2015–16 budgets shows some reduction in overall central transfers to states (even after increases in CSS through supplementary budgets). The reduction particularly impacted social sector investments. Isolating central transfers specifically for the social sector, Choudhury, Mohanty, and Dubey (2018) found that as a percentage of GSDP, central plan transfers for social sector fell for almost all major states between 2014–15 and 2015–16. How did state governments respond to this reduction in transfers?

State budget data suggests that overall investments for social sector¹⁰ have not fallen. Analysis of 20 state budgets¹¹ indicate that the total quantum of funds for the social sector increased by 19% in nominal terms from Rs. 6.09 lakh crores (USD 89.6 billion) in 2014–15 actuals to Rs. 7.23 lakh crores (USD 106.3 billion) in 2015–16. However, as a proportion of Gross Domestic Product (GDP) it remained constant at 6% (Table 3).

States have not used their enhanced flexibility to increase investments in social sectors either. Rather the norm is to maintain the status quo. This

Table 3. Change in social sector expenditures.

| | 2014–15A in USD million | 2015–16 A in USD million | Change in social sector | Share of social sector as a % of GSDP (2014–15) | Share of social sector as a % of GSDP (2015–16) |
|------------------|-------------------------------|-----------------------------|----------------------------|---|---|
| Himachal Pradesh | 1173 | 1290 | 10% | 8% | 8% |
| Punjab | 2136 | 2313 | 8% | 4% | 4% |
| Uttarakhand | 1496 | 1587 | 6% | 6% | 6% |
| Rajasthan | 6411 | 7256 | 13% | 7% | 7% |
| Madhya Pradesh | 5020 | 6717 | 34% | 7% | 8% |
| Chhattisgarh | 2492 | 2669 | 7% | 7% | 7% |
| Bihar | 4910 | 5689 | 16% | 10% | 10% |
| Jharkhand | 1886 | 2333 | 24% | 6% | 7% |
| Odisha | 3419 | 4055 | 19% | 7% | 8% |
| Gujarat | 6456 | 7138 | 11% | 5% | 5% |
| Andhra Pradesh | 4837 | 7186 | 49% | 6% | 8% |
| Telangana | 2891 | 4797 | 66% | 4% | 6% |
| Karnataka | 6404 | 7591 | 19% | 5% | 5% |
| Kerala | 3617 | 4212 | 16% | 5% | 5% |
| Haryana | 3091 | 3394 | 10% | 5% | 5% |
| Maharashtra | 11,604 | 12,486 | 8% | 4% | 4% |
| Uttar Pradesh | 10,832 | 13,852 | 28% | 7% | 8% |
| Tamil Nadu | 8027 | 8892 | 11% | 5% | 5% |
| Sikkim | 228 | 211 | –7% | 10% | 8% |
| Assam | 2744 | 2696 | –2% | 10% | 8% |
| Total | 89,674 | 1,06,363 | 19% | 6% | 6% |

Source: Authors calculations based on Finance accounts (Comptroller and Auditor General of India 2015 and 2016) and State budgets. For GSDP, data has been taken from the Central Statistical Organisation and is based on base year for 2011–12. Exchange is calculated as 1 USD = 68 INR.

becomes even more apparent when analysis is restricted to states which saw a significant increase in untied funds. As highlighted in [Table 4](#), in states where untied funds increased by over 10 percentage points, social sector expenditure as a share of GSDP remained relatively constant.

Importantly, the overall expenditure trend is similar regardless of development levels. Himachal Pradesh, for instance, has a high per capita income¹² of Rs 1,34,376 (USD 1976), high literacy levels of over 80%¹³ and low infant mortality rate¹⁴ (IMR). Chhattisgarh, on the other hand, is much poorer. In 2015, the state had a per capita income of Rs. 84,767 (USD 1247) with poorer performance on social indicators. Yet, both states see relatively similar responses to the change in fund availability. Both states received a near 15 percentage point increase in untied funds. However, the percentage increase in social sector spending was less than 1 percent in Himachal. In Chhattisgarh, expenditure in social sectors saw a marginal drop.

Conceptually, increased untied transfers to states allows states greater flexibility in expenditure, such that investments could reflect state specific priorities. Thus, it would be reasonable to expect shifts in expenditure across sectors. However, a deeper dive within the social sector suggests that this has not been the case (see [Figure 2](#)).

One possible factor that likely affected state governments's ability to use their new found flexibility to reallocate expenditures was that the CSS financing mechanism saw an important change. In October 2015, the Union government enhanced the state's contribution for a number of CSSs¹⁵ and State governments were expected to pay for this additional money through their untied funds. This led many state governments to argue that flexibility in the post FFC era had in fact reduced.

State budget data does not allow for clear disaggregation of expenditure to understand fiscal space. However, a review of a few states indicates that despite changes in CSS fund sharing ratios, states did have some discretionary funds available (see [Table 5](#)) resulting in a net enhancement in flexibility. Yet, social sector spending remained static.

Table 4. Change in untied funds versus change in social sector expenditure.

| | Percentage point change in untied funds | Percentage point change in Social Sector Expenditure as a proportion of GSDP |
|------------------|---|--|
| Andhra Pradesh | 13% | 1.8% |
| Chhattisgarh | 17% | -0.3% |
| Haryana | 14% | 0.0% |
| Himachal Pradesh | 28% | 0.1% |
| Karnataka | 14% | 0.3% |
| Punjab | 10% | -0.1% |

Source: Authors calculations based on Finance accounts (Comptroller and Auditor General of India 2015 and 2016) and State budgets. For GSDP, data has been taken from the Central Statistical Organisation and is based on base year for 2011–12.

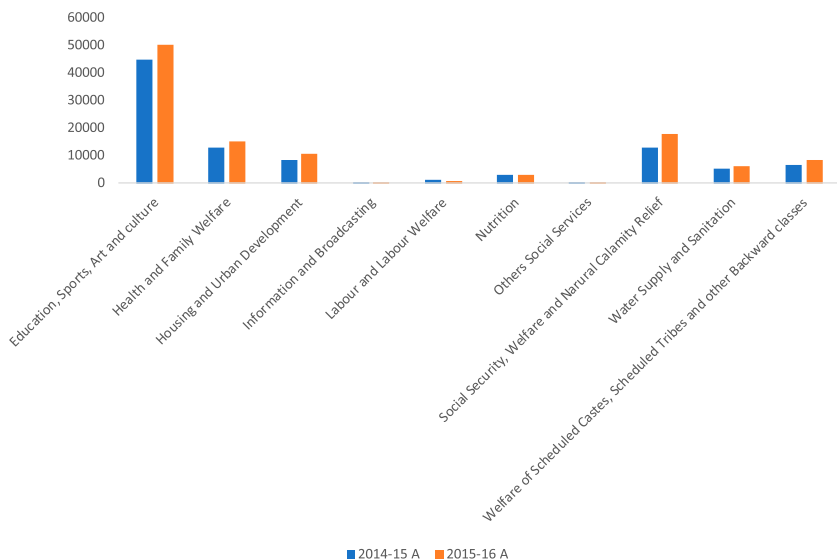


Figure 2. Disaggregated Social Sector Expenditure (in USD million). Source: Authors calculations based on state budgets (various years). Does not include Sikkim.

The analysis above indicates that state governments have not made use of their new-found flexibility to make any changes in the nature and quantum of investments in their states. It could well be argued, as several state government bureaucrats did during our interviews, that it is still too early to see any dramatic shifts as committed expenditures had to be completed. However, our interviews, as discussed in the next section, also seem to suggest a lack of planning and vision in this direction and it is unlikely that the current status quo will change significantly in the near future.

CSS in the post FFC era

The implementation of the FFC recommendations was followed by the submission of the recommendations by the NITI Aayog's Sub-group of Chief

Table 5. Net fiscal space available with states USD Million.

| Name of State | Additional untied receipts from the Centre | Increase in State share for CSS in 2015–16 versus 2014–15 | Fiscal space remaining | Percentage point increase in social sector spending as a % of GSDP between 2014–15 and 2015–16 |
|---------------|--|---|------------------------|--|
| Gujarat | 655 | 197 | 458 | 0% |
| Kerala | 1115 | 93 | 1023 | 0.3% |
| Maharashtra | 1244 | 527 | 717 | –0.2% |
| Odisha | 1164 | 702 | 462 | 0.9% |

Source: Authors calculations based on data collated from finance accounts (Comptroller and Auditor General of India 2015 and 2016) and state budgets (various years). Exchange rate at 1 USD = 68 INR.

Ministers on Restructuring CSSs in 2016. The report made some key recommendations on increasing fiscal flexibility to states. These included first, demarcating 25% of a scheme's allocation as flexi-funds to be spent as per state needs and the introduction of transparent criteria for allocation of funds to facilitate planning. Second, it proposed the introduction of greater flexibility in the choice of schemes to be implemented at the state level. To this end, the Sub-Group recommended clustering multiple CSS under one umbrella programme and allowing states to choose their priority area. For example, within the education umbrella, the report recommended states be given the flexibility to decide if they wanted to prioritise elementary education or secondary education, based on their development needs. These coupled with the FFC recommendation to reform the design and implementation of CSSs, created the expectation that the CSS fund transfer system would see significant changes, post the completion of the 12th Five Year Plan.

This however, has been not done. The 2016–17 and 2017–18 budgets saw some restructuring of CSS. But this was perfunctory. Schemes were re-ordered in to 'core of the core', 'core' and 'optional' with no change to implementation. The Union government did issue a notification that each CSS would allocate 25% funds as flexible, discretionary funds (Ministry of Finance 2016). However, analysis of scheme guidelines and budget documents indicate that this has not been implemented. Instead, a close reading of the planning meetings for education and health programmes, where states proposals are discussed and budget approvals are determined, indicate that flexibility is limited and Gol continues to play a key role in determining priorities and associated allocations. This is evident from the fact that the funds approved by Gol across various components of the education (SSA) and health (NHM) budget continue to be less than the budgets proposed by States in 2014–15 (before the restructuring effort) and 2015–16 (after the restructuring was implemented) (see [Figures 3 and 4](#)).

In sum, from the perspective of social policy, the effort to restructure the federal framework for social policy financing through greater fiscal decentralization has not resulted in any major disruptive shifts in social policy expenditure at the sub-national level. Rather, state governments' have preferred to maintain the status quo. FFC recommendations have not been implemented in spirit. State governments have chosen to blame the centre arguing that the centre has not lived up to its commitments to effectively decentralize. As one state official interviewed said, *'The FFC had some very good ideas, but the Union Government did not adhere to the changes envisaged for CSSs. As a result, we are back to exactly where we started.'*¹⁶ Our analysis of budget data presented here refutes this perception. States do indeed have greater flexibility in the post FFC regime, despite the continued presence of CSS. However, no state government has attempted to make good on their new-found flexibility.

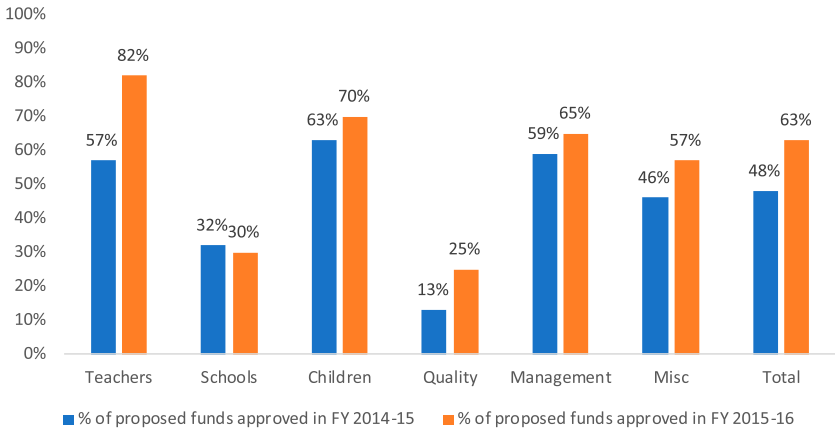


Figure 3. Proposed funds versus approved funds under Sarva Shiksha Abhiyan. Source: Accountability Initiative (2016-17).

Instead, as we discuss below, the focus has shifted to lobbying for the reinstal-lation of the very CSS that they wanted freedom from!

Understanding the centralization vs decentralization tug of war: A discussion

From the perspective of its effects on social policy investments, the post FFC budgets are best characterised as representing systemic inertia in financing

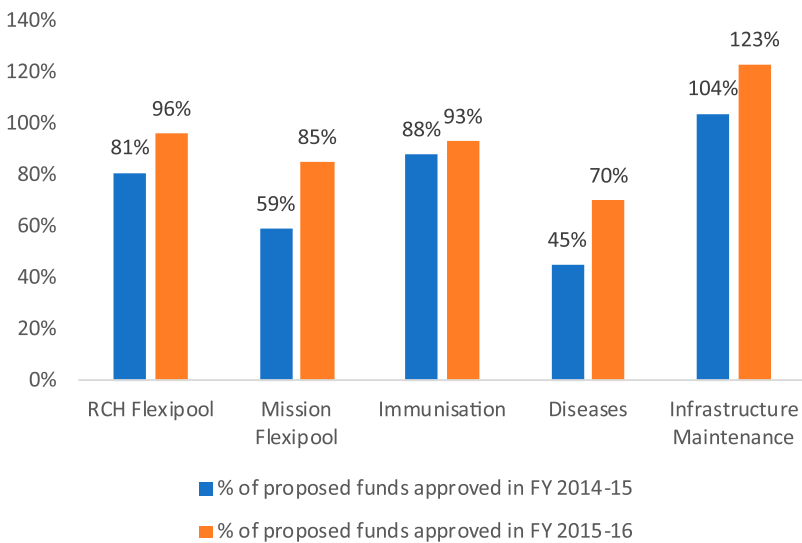


Figure 4. Proposed funds versus approved funds under the National Health Mission (2016-17). Source: Accountability Initiative (2017-18b).

social policy. As highlighted in the analysis above, the acceptance of the FFC recommendations served to alter the overall structure of financing available to states, giving most states greater access to untied resources. In principle, this ought to have resulted in some shifts (upward or downward) in social sector investments. However, this has not been the case. Rather, state budgets reflect a status quo. Overall social sector investments in the period 2014–15 and 2015–16 have remained steady at 6% of GDP. Importantly, the centralised dynamic of CSS financing remains unchanged.

It could be argued that the current data available reflects early trends that are likely to be reversed as the changes take root. However, we speculate that the possibilities of seeing dramatic shifts in budget are remote. Our pessimism stems from the fact that in political rhetoric and in interviews and discussions with key officials,¹⁷ we found a lack of interest and preparedness at the state level on how to utilise the opportunity of greater access to untied funds for changing patterns of social sector investments. Rather than welcome the recommendations of the FFC, almost immediately after the 2015 Union budget was tabled, the rhetoric at the state level shifted to the cuts in CSS's and changes in the fund-share pattern.

For instance, the Karnataka state finance minister during his budget speech said,

The Central Government gave the impression . . . that States would be getting a huge financial largesse However, our happiness was short-lived. . . what has been given by the Central Government on the one hand has been taken away by the other hand. (Government of Karnataka 2015)

In a similar vein, the Chief Minister of Odisha accused the Union government of 'step-motherly treatment' stating,

Odisha has been hit on two counts — unfavourable recommendations of 14th Finance Commission and lesser plan allocation in Budget. Even though there is a talk of focus on irrigation and agriculture in the Budget, the allocation towards the crucial sectors has been abysmally low.¹⁸

This sentiment was echoed by many others in the NITI Aayog meetings on CSSs. In the report documenting these meetings, the Chief Minister of the state of Andhra Pradesh goes on record to state, '*The reduction of the Central share for key schemes . . . will have adverse effect on the State development indicators.*' (NITI Aayog 2015). The Chief Minister of Bihar was similarly critical, stating, '*(The) 14th Finance Commission has done more harm than good to the State. As per the recommendations of 14th Finance Commission, there is a reduction in the resources of the State . . .*' (NITI Aayog 2015).

Concerns were also raised by social activists and policy commentators on the implications of the cuts in CSSs on social policy in India, arguing that this is likely to result in a significant drop in social policy investments in

state.¹⁹ Noted activist Jean Dreze sums up these concerns in the following words, '*anyone with a minimal understanding of Centre-State relations is likely to hear alarm bells.*'²⁰

Two years on, despite the fact that budget data suggests status quo rather than any significant fall in investments, these concerns remain central to the narrative on the effects of the FFC on social policy investments. In interviews with key bureaucrats in finance and social sector line departments at the state level, officials repeatedly argued for the importance of CSSs for social sector investments. CSSs, the argument goes, serve the purpose of 'ring fencing' money for social sectors. As one interviewee argued, allocations in most states are made by the finance department entirely on the basis of directions from the Chief Ministers office keeping political rather than policy considerations in mind.²¹ Further, as this bureaucrat and many others interviewed argued, CSS served the important role of ring-fencing funds for social sectors. Activists and politicians too share this view (Aiyar 2015; Tharoor 2015). There was a near consensus in writings post the 2015 budget that the centre had, by reducing budget and placing responsibility for social sector spending on states, abdicated itself of its national duty and that States had neither the funds nor the political will to make up the funding gap (Aiyar 2016).

Importantly, in what appears to be a direct contradiction of the demands for greater flexibility, many state officials argued that state level planning capacity is weak and therefore, it is far easier to invest in social sectors through CSSs because 'they come with clear guidelines and rules'.²² In fact, line department officials we interviewed specifically argued that the 'flexibility' they would seek is within the CSS structure, changes in unit costs and infrastructure norms for instance, rather than complete flexibility at the state level in designing and implementing social sector programmes.

What emerges from this analysis of state budgets and the rhetoric and positions taken by state actors is a near consensus in favour of the status quo – a centralised rather than decentralized financing architecture for social sectors. This consensus is puzzling considering that the FFC recommendations were formulated as a direct response to demands from states. By convention (and design) all FCs conduct a detailed set of dialogues with state governments. In these interactions, the FFC report notes a marked preference for formula-based predictable fund transfers through devolution of taxes. The report states that almost all state governments raised concerns over the growing trend of attaching conditionalities to grants, which made spending difficult. Some states also argued that the conditions-linked, discretionary transfers violated the principle of state autonomy. States were particularly vocal in their preference for reducing CSS. According to the FFC,

States have, suggested that the funds transferred by the Union Government for expenditure on State subjects through various CSS should be subsumed under

the funds transferred through vertical devolution. The States have emphasised that there is a need to enhance the existing level of formula-based fiscal transfers. (Finance Commission 2015)

This demand for reduction in CSS is not new. As highlighted in the discussion on CSS earlier in this paper, States, from as far back as 1969 have argued against the overwhelming centralised nature of CSS and against increased encroachment by the centre in areas that are constitutionally the state government's mandate. Several commissions preceding the FFC²³ have noted the negative consequences, as articulated by state governments, of the proliferation of CSSs and sought to reduce their size and induce greater flexibility. Yet, when the FFC and the NITI Aayog subcommittee created the opportunity for a radical restructuring, states seem to have shifted their stance. In fact, the political posturing and perspectives of bureaucrats seems to reveal a preference toward a strong CSS based centralised approach to social sector financing. It is instructive that the Terms of Reference (ToR) of the 15th FC seek to push the newly formed commission toward reversing the FFC recommendations and specifically incentivizing states through performance grants linked to CSS.²⁴

What explains this shift in position by state governments? Why is it that states, despite the repeated demands for greater decentralization, prefer the status quo? And what are the implications of this revealed preference for centralised funding on the key analytical concern of discussions on fiscal decentralization and social policy – the trade-off between expenditure efficiency and greater local accountability versus regional variation in outcomes? In this section we offer a set of speculative explanations on why the phenomena of centralisation in the inter-governmental fiscal bargain persists and examine the consequences of centralised social policy financing on regional equity going forward.

The first possible explanation for the persistence of centralisation in social policy financing lies in the political economy of centre-state relations. As highlighted previously, India's political landscape is extremely decentralized. In this decentralized political landscape, states became critical sites, shaping the dynamics of India's politics (Tillin and Pereira 2017; Yadav and Palshikar 2009). As states become more powerful, so did the state political leaders, particularly state Chief Ministers. By the 2000s Chief Ministers in many states began to buck the anti-incumbency trend that dominated state and national politics since the late 1970s and consolidate their hold on power over multiple elections (Tillin 2017).

From the perspective of social policy, these powerful chief ministers played a very important role in shaping social policy priorities in states. States have been documented as becoming important sites for social policy reform and innovation and state chief ministers emerged central drivers behind these

reforms (Aiyar and Walton 2015; Deshpande, Kailash, and Tillin 2017). An important characteristic of this new welfare landscape was the dynamic that state governments developed vis a vis central scheme. As mentioned, in India's federal system, state governments are charged with implementing social policy schemes including those financed by the central government. As central schemes began to dominate the social policy landscape in the early 2000s owing to their large budgets and high political visibility, state Chief Ministers' were quick to recognize the electoral value of these schemes and leveraged their role as chief implementers to take political credit for central schemes that they implemented well (Tillin 2017; Tillin and Pereira 2017). Equally, the central government became an easy target for states that failed to implement social policy programmes effectively. This is well illustrated in the electoral battle that played out in the state of Uttar Pradesh for the 2012 state elections over the Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA). In the run up to the elections, the Congress led UPA blamed the state government for poor implementation and corruption in the MGNREGA and attempted to use this as an important electoral plank. The UP government, then headed by Chief Minister Mayawati from the Bahujan Samajwadi Party was quick to blame the centre for implementation failure attributing failure to the slow release of funds by the centre that made implementation difficult.²⁵

This dynamic of apportioning blame and credit as convenient is well served through a centralised financing architecture. And it is one possible reason why, a deeply decentralised polity can co-exist comfortably with a centralized fiscal architecture.

This ability to blame the centre (and states) has also influenced the electoral incentives for Chief Ministers and national politicians in ways that have affected state capacity at the grassroots. The local bureaucracy in India is chronically under resourced and understaffed (Chaudhury et al. 2006; Dasgupta and Kapur 2017). Kapur and Dasgupta draw on a survey of 426 Block Development Offices (the administrative unit closest to the village) in 25 states to highlight that the average BDO has 24.5 full time employees per 100,000 rural residents. Moreover, 48% of posts sanctioned by government were reported vacant. Studies on health and education programmes by Accountability Initiative highlight that these vacancies tend to be more acute in poorer states (Accountability Initiative 2017–18a, 2017–18b, 2018–19a, 2018–19b). These limited resources are an important reason for the persistence of regional inequality in India despite a centralised fiscal architecture. Theoretically, a well-designed centralized financing architecture serves the purpose of ensuring equalization in spending across regions to ensure that minimum standards of public services are provided to all citizens (See Acosta and Tillin, forthcoming; Besley and Coate 2003; Courchene et al. 2000). This is the stated logic of CSSs. However, analysis of state budgets

point to significant underspending in poor states owing in part to poor staff capacity (Accountability Initiative and Centre for Global Development 2015; Mathew and Moore 2011).

Dasgupta and Kapur (2017) highlight the role of perverse electoral incentives for the persistence of weak state capacity. They hypothesise that while politicians see clear electoral gains to announcing and inaugurating ambitious social policy programmes, the incentives to invest in local state capacity to implement these programmes well are diffuse and uncertain. Consequently, the political willingness to invest in building capacity – hiring staff, streamlining systems – is relatively low. If this argument were extended to the particular issue of the financing architecture, a similar argument would hold: State politicians have few incentives to invest in state capacity because they can, in a centralised fiscal architecture, place the blame for poor implementation on the centre. This also allows politicians to prioritise social policy innovation in areas where they anticipate large political gains (for example, the public distribution system in Chhattisgarh) or areas that are of personal interest to the Chief Minister and party leadership (an interesting example is Nitish Kumar's focus on education in the 2005–2014 period (Banerji 2014)) while paying less attention to other critical areas of public service delivery. Chhattisgarh for instance, which has invested significant political capital improving its public distribution system (Deshpande, Kailash, and Tillin 2017) has paid far less attention to strengthening education. This is evidenced from the fact that Chhattisgarh ranks among the bottom ten Indian States and Union Territories on the National University of Educational Planning and Administration's (the government's research arm for education) Educational Development Index 2013–14 (NUEPA 2014). Ironically, these limited investments in state capacity have served to strengthen the argument for greater centralization of social sector financing. As highlighted above, in the aftermath of the implementation of FFC recommendations, many states pointed to weak state capacity as one reason for the continuance of CSS with its clear rules and guidelines.

Against this background, the rhetoric for greater decentralization of CSS that periodically finds voice in political debates, platforms like the Sarkaria Commission and the discussions held with the FFC can best be interpreted as an important political pressure tactic in the centre-state dynamic for access to greater resources on the one hand and electoral gains on the other. Underlying this pressure tactic is an incentive structure that privileges centralisation of social policy financing. In this political economy the core goal of centralization – to ensure equity – is undermined while the expectation of decentralization – greater accountability through alignment of expenditure with local needs and preferences, fails to take root. India is thus likely to continue to see vast regional variation in social policy outcomes, despite a centralised financing architecture.

A second explanation for the persistence of centralisation in social policy can be found in the hierarchical culture of the bureaucracy. The role of the bureaucracy is a relatively under studied aspect of the dynamics of India's inter-governmental fiscal bargain. Yet as we have demonstrated in the section on CSS above, bureaucratic negotiations are critical to framing the nuts and bolts of centralised intervention in CSS implementation.

Constitutionally, India is governed through a central bureaucracy (the elite all India Indian Administrative service or IAS) which is supported by an independent bureaucracy in each state. However, the relationship between the IAS and state governments is complex. The IAS by design has a dual control system of accountability. As an All India service, IAS officers are expected to serve the central government. But they serve the centre through the state governments. All IAS officers are assigned to particular 'states' where they spend the bulk of their careers. Thus, for all practical purposes are part of the state level bureaucratic hierarchy as well as the centre's (Krishnan and Somanathan 2017; Rao and Singh 2005). As Singh and Rao highlight, IAS officers spend their early career in the states but the prized jobs – the ones with greater prestige and power – lie at the central level. Consequently, allegiance to the bureaucratic hierarchy at the centre, is critical to an IAS officer's future. In social policy, this dual accountability has served to entrench an organisational culture, institutionalized through the CSS model of financing, in which central government bureaucrats dictate implementation terms to bureaucrats at the states level (Sanan 2014). State bureaucrats are incentivized to follow rules and bureaucratic procedures as they consider themselves accountable to their central government bosses. As one official interviewed stated, 'State governments normally function on implementation mode, not planning mode.'²⁶ Moreover, in the specific context of CSS, many CSS's are implemented through specially created societies that allow bureaucrats to route money outside the state treasury and interact directly with the society officials. Social sector bureaucrats are thus more accountable to central line departments than to their own state governments blurring lines of accountability with the state. In this accountability system, decentralization to states is actively resisted by the bureaucracy at the central and state government level.

But this is a vicious cycle. In a centralised financing system, rules and processes created by the centre become the basis for measuring compliance and determines fund releases and subsequent fund allocations to states. The resultant institutional incentives have discouraged state governments from investing in their planning capabilities thereby weakening state level institutions (Jhingran 2014; Sanan 2014). Consequently, central government line ministries have legitimized their role in social policy as that of micro managing state decision making thereby deepening centralization. Unsurprisingly,

weak capacity at the state level was an oft cited reason for a return to the CSS era.

Ironically, this culture of bureaucratic centralization has been deepened by the NITI Aayog, despite its rhetoric of co-operative federalism. Swenden and Saxena (2017) in an important study of the design of the NITI Aayog highlight that it remains a central government institution firmly under the control of the central political and bureaucratic hierarchy. Saxena and Swenden point to the fact that the NITI Aayog is largely peopled with staff from the central government cadre drawn from union ministries and secretaries that work in close coordination with the Prime Minister's Office. Moreover, the NITI Aayog created regional councils to address state specific issues. However, the PM and the cabinet have the freedom to accept or reject the recommendations of these councils. The limited impact of the regional councils is evident in the fact that the CM subcommittee report has been ignored.

To conclude, the culture of centralization within the bureaucracy coupled with the lack of political incentives for fiscal decentralization at state level suggest that India is unlikely to see a long-term change in the fiscal federal dynamics of social policy financing. As early as 1966, the First Administrative Reforms Commission had observed that the role of the Union Government should be largely that of a 'pioneer, guide, disseminator of information, overall planning and evaluator' (Finance Commission 2015). Instead the centre has increasingly taken on the role of planner, implementer and monitor creating many distortions in the implementation of social policy in India and promoting an institutional and political culture that is deeply resistant to decentralization reforms. It is no surprise therefore that the potential for far reaching impact of the FFC has been all but subverted and despite the rhetoric of greater decentralization, the architecture of fiscal federalism for social policy remains unchanged.

Conclusion

This paper has traced the emerging narrative on fiscal federalism for social policy in India. Through our analysis we have attempted to demonstrate the importance of understanding the effects of fiscal decentralization on social policy through the lens of the political and administrative dynamics that shape inter-governmental fiscal bargains. From the perspective of the core analytical question that this paper sought to unpack – the potential trade-offs between greater fiscal decentralization and local autonomy on the one hand and regional equality and provision of inclusive public services on the other – our analysis highlights that this question cannot be answered by studying the institutional design of fiscal decentralization alone. India's experience with attempting to increase fiscal decentralization to states and empower states to take on greater financial responsibility for social

policy shows that state governments' capacity and willingness to leverage fiscal decentralization is shaped significantly by the pulls and pressures of political and administrative inter-governmental bargains. Consequently, centralised financial systems, like the CSS model, often fail to achieve equity goals because regional political dynamics impact the quality of implementation. At the same time, this political and associated administrative incentive structure, as we have highlighted in this paper, can serve to undermine efforts to deepen fiscal decentralization thereby blunting the potential positive impact – greater alignment with local preferences and therefore greater accountability – of fiscal decentralization and social policy outcomes.

Notes

1. Devolution is determined as a proportion of the total divisible pool of taxes. The divisible pool comprises total central taxes (excluding the revenue from earmarked taxes) minus the revenue from cesses and surcharges and cost of collecting the taxes.
2. For details on the NITI mission statement, see <http://niti.gov.in/content/overview>
3. <http://pib.nic.in/newsite/PrintRelease.aspx?relid=167296>; http://www.huffingtonpost.in/2015/02/07/niti-aayog_n_6638440.html; http://www.business-standard.com/article/economy-policy/imbibe-spirit-of-competitive-cooperative-federalism-pm-narendra-modi-117071001281_1.html.
4. Established in 1952, the National Development Council (NDC), is an apex decision making body comprising of the Prime Minister, members of the Union Cabinet and Chief Ministers' of all states. The primary purpose of the NDC was to support the centralized planning effort through cooperation with the States.
5. It is important to note here that states have often been deliberately slow at meeting pre-determined conditionalities, for instance releasing their share of central funds, creating a vicious cycle of delayed releases and slow expenditure. See Aiyar et al. (2015) "Rules vs Responsiveness" for a more detailed analysis of the budgetary dynamics associated with CSS bargains.
6. For instance, the 13FC recommended 10 different grants in aid including specific grants for elementary education, environment, roads and bridges and performance grants with incentives to improve outcomes in key areas as a supplement to its tax devolution and general-purpose grants-in-aid. These totalled Rs. 14,446 crore (USD 2124 million) over the 5-year period (2010–15). (Exchange 1 USD = 68 INR).
7. 8 schemes were delinked from Union government financing, 24 schemes were going to receive lower Union government funding and the remaining 31 schemes would remain unchanged.
8. Untied transfers include tax devolution, normal central assistance and finance commission grants. All other transfers have been classified as tied.
9. The analysis excludes the first year of the 13th FC period and thus covers 4 years from 2011–12 to 2014–15.
10. We have followed the states' own classification of different sectors in our analysis. To ensure comparability, we have used the CAG's definition of social services which excludes expenditure incurred by the rural development department.

11. GSDP data for West Bengal is not available.
12. Per capita income has been taken from Central Statistical Organisation and is in current prices.
13. Literacy rate as per Census 2011.
14. IMR from Sample Registration System. Collated data available online at: <http://niti.gov.in/content/infant-mortality-rate-imr-1000-live-births>.
15. For instance, the fund sharing ratio for NHM and SSA was revised to 60:40 between the Union government and states from 75:25 and 63:35, respectively.
16. Interview in Jaipur, Rajasthan, June 7, 2017.
17. The insights gathered here are based on 10 formal, semi-structured interviews with eight senior bureaucrats from four state governments were conducted specifically for this paper in the summer of 2017 (Rajasthan, Bihar, Chhattisgarh and Kerala). In addition, views were sought from over 30 participants in two different workshops conducted on the implementation of the FFC. These include a workshop in February 2016 attended by 30 state level politicians in which one of us made a presentation and sought views from participants on the effects of the FFC. The second workshop conducted in May 2016 where views were sought from 4 senior policy makers at the national and state government level. In addition, state specific sharing workshops were organised with finance and other line department officials between July 2015 and November 2016 to share details of findings from budget analysis of the implications of the FFC on social sector spending. These meetings were held in the states of Rajasthan, Bihar, Himachal Pradesh, Maharashtra and Tamil Nadu. Through these meetings we engaged in one on one conversations with 15 senior state level bureaucrats.
18. <http://indianexpress.com/article/india/india-others/odisha-cm-naveen-patnaik-accuses-centre-of-step-motherly-treatment/> and <http://indianexpress.com/article/business/budget/patnaik-changes-track-says-shocked-by-budget/>.
19. <http://timesofindia.indiatimes.com/india/Children-most-neglected-in-the-2015-16-Union-Budget-Child-rights-organisations/articleshow/46537698.cms>; <http://indianexpress.com/article/business/budget/activists-cry-foul-as-wcd-ministry-funds-slashed-by-half/>; <http://www.hindustantimes.com/business/big-budget-cuts-in-education-sector-worry-activists-ngos/story-QBsHgQjpdBvmNTLYjBHT6J.html>.
20. <http://www.thehindu.com/opinion/lead/nehruvian-budget-in-the-corporate-age/article6959755.ece>.
21. Interview in Thiruvananthapuram, Kerala, May 11, 2017.
22. Interview conducted in Jaipur, Rajasthan June 7, 2017.
23. See for instance the Sarkaria Commission Report and M. M. Punchhi Commission Report (Ministry of Home Affairs 1988, 2010).
24. The terms of reference of the FFC issued in January 2018 have been the subject of much public and political controversy. The key rallying point of the controversy is related to the population base to be used in designing the formula for devolution to states. In addition, state governments (and commentators) have highlighted aspects of the terms of reference that seek to bias the finance commission towards centralization by reconsidering the FFC recommendation for enhancing tax devolution to states on the one hand and introducing incentive grants seeking to reward states that are implementing central schemes well. (For more on the unfolding controversy see Aiyar 2018; Rao 2018).

25. <https://www.hindustantimes.com/lucknow/maya-ramesh-spat-gets-messier-reaches-pm/story-Ckr0KITPZlg8rxzDMjpFZI.html>, The Woodrow Wilson School's Graduate Policy Workshop Report (2012) "MGNREGA Implementation: A cross state comparison" downloaded from <http://www.indiaenvironmentportal.org.in/files/file/MGNREGA%20Implementation%20A%20Cross-State%20Comparison.pdf> (downloaded on 22 May, 2018).
26. Interview in Patna, Bihar, June 6, 2017.

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