



Impact of Union Budget 2025-26 on Fiscal federalism in India

(A Case Study of Telangana State)

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Abstract

Richard Musgrave, German economist initially used the term of 'fiscal federalism'. He said that financial relationship and resource allocations between central and state governments of India are the system. It refers to distribution of financial allocations and responsibilities between central and state governments. Fiscal federalism is the backbone of economic development. The Indian constitution article 270, clearly explains the financial roles of central and state governments. The seventh schedule of the constitution reveals the division of structure through the union list, state list, and concurrent list, explaining the legislative and taxation powers at different levels. If there is any imbalance prevailing in the tax collection, tools such as devaluation, grant -in-aid and other financial mechanisms are applied to bring financial stability. Under article 270 of the constitution of India, finance commission was constituted which recommended that strong states built a strong nation. As per the 14th finance commission, devolution increased from 31 percent to 42 percent which plays a vital role in strengthening fiscal federalism and increasing of financial authority for states by providing more resources. This type of flexibility enables the states to implement policies to their respective needs. As per the union budget 2025-26, the total transfer of taxes and duties of Rs 14, 22,444. crore were allocated to different states.

This shows union budget responsibility for making states equal partners for achieving the growth.

In the case of Telangana, union budget has once again failed to address the critical challenges faced telangana state. Increased cess while reducing custom duties on certain goods would shrink the divisible goods of taxes negatively impacting state's revenue share. Despite repeated calls from states, center's financial decisions continue to disregard state priorities. Bihar State having surplus revenue, receiving substantial funds while Telangana remains neglected. Due to this, state government borrowing funds from various sources which come

around Rs 68,000 crore by march 2025.

Keywords: Fiscal Federalism, Financial Allocation, Financial Stability, Devaluation, Grant-in-aid, Union Budget.

Introduction

Finance minister, Nirmal Sitharam, submitted ambitious road map of 'Viksit Bharat' on 1st February 2025 to the parliament in which she emphasized unique opportunity of 'Sabka Vikas' and balance regional development. The 'Viksit Bharat' which brings a strong partnership between the centre and states. This collaboration is needed not for economic development but for achieving balanced development among the various states for which various schemes are introduced under fiscal federalism to achieve the goal. The term of fiscal federalism was primarily used by the German economist, Richard Musgrave who describes the financial relationship and resources allocation between different states or regions in a federal system of India. It refers to the distribution of financial powers and responsibilities between the central and state governments.

Fiscal federalism is the backbone of Indian economic development. As per the Article 270, Indian constitution clearly explains the financial role of centre and states. The structure is divided into union list, state list, and concurrent list.

The schedule of the constitution, clearly explains legislative and taxation powers of central and state governments to bring vertical or horizontal imbalance of tax collection, tools of devaluation, grant-in aid and other financial transfers from centre to states are to be applied to bring financial stability.

For one decade, the central government laid foundation for fiscal - federation while maintaining a strong emphasis on fiscal discipline with compromise on the devolution. The union budget 2025-26 enhanced the further to the level of Rs 25, 59,764 crore which helps to center's commitment to co-operation federation and regional balanced development. The main purpose is to stimulate economic development supported by important sectors and providing tax relief to the middle class.

Review of Literature

- 1) V. Anantha Nagewaran (2025) 'Road map for viksit Bharat' in which he said that income distribution between the capital and labour is crucial for stability and inclusive growth.
- 2) Dr. Sajjan Singh Yadav (2025) 'Fiscal Federalism in India: The role of union budget 2025-26' in which he says that this budget reinforces India's commitment to co-operative fiscal federalism.
- 3) Sanjeev sonyal (2025) 'Budget 2025: clearing India's next infrastructure Frontier' in which he said that the union budget 2025 gives ship building infrastructure status to bolsters' Indian maritime applicability, creating a comprehensive ecosystem for growth.
- 4) Ravi agarwal (2025) 'Budget 2025-26 to words tax performs' in which he says that this budget is described as prudent, proactive, responsive, user friendly digitally enabled environment that is inclusive and transparent.
- 5) Shishir Sinha (2025) 'Balancing production and consumption for economic growth' in which he says that economic growth is measured not just in terms of gross domestic product or GDP but also in Gross Value Added (GVA) and tax reforms in the union budget 2025-26 is aimed at addressing both.

- 6) abanya Prakash Jena (2025) ‘Green Budgeting in India: A step towards sustainable developmental which he says that 2026 budget reinforces its commitment to climate goals with increased funding for clean energy environments conservation.
- 7) Prof. Roli Mbra (2025) ‘Gender budgeting: A road map towards insensitivity in which he said that this budget evaluates the effectiveness of gender budgeting as a means of reducing the gender gap in the action.
- 8) Syed salman Haider (2025) ‘India’s rapid stride in the Field of solar energy which he said that it is hoped that India will not only achieve the target of 300 GW of installed capacity of solar power but also substantially reduce the import bill.

Scenario of Fiscal Federation of Telangana State

Mallu Bhatti Vikramarka, deputy chief minister, who also holds the financial port folio said the union budget has once again failed to address the critical challenges faced by Telangana. He argued that the increased cess while reducing customs duties on certain goods, would shrink the divisible pool of taxes negatively impacting states revenue share. He said that despite repeated calls for greater autonomy, the central financial decisions continue to disregard state priorities He says that allocation to Bihar State, despite its surplus revenue while Telangana government neglected.

Recently, the telangana government decided to raise the borrowings to the extent of Rs 30,000 crore through the weekly auction of government securities conducted by Reserve Bank of India for the fourth quarter. However, govt. Raises Rs 13,800 crore through the five action till 11th march, 2025. According to provisional figures submitted by the comptroller and editor general of India. State government raised Rs 58,586 crore in the form of borrowings by January, 2025. Total borrowings come around Rs 68,000 crore by 31-March, 2025.

Impact of Fiscal Federalism

The finance minister presented the union budget 2025-26 with the theme of ‘Sabka Vikas’ stimulating balanced growth of all regions.

- 1) Zero poverty.
- 2) Hundred percent good quality school educations.
- 3) Access to high quality affordable and comprehensive healthcare.
- 4) Hundred prevent skilled labour with meaningful employment.
- 5) Seventy percent women in economic activity and Farmers making our country the ‘Food basket of the world’.

Objectives of the Study

- 1) To know the principles ‘governing fiscal federalism.
- 2) To study the provisions en-shined in Indian Constitution relating to divisions of financial powers between union and state.
- 3) To know the appreciation role of financial commission versus planning commission.
- 4) To examine the various recommendations of 12th finance commission.
- 5) To know the nature of issues involved in contemporary situations prevailing in the country.

Hypothesis

- 1) The revenue shares of states are not decreasing.
- 2) The states are not depending more and more on central sponsored schemes.
- 3) Borrowing restriction is not increasing.

Challenges of Fiscal Federalism

- 1) Decline in revenue shares: The 15th finance commission has reported that a significant drop in revenue shares for states like Karnataka (4.7 percent to 3.65 percent) and Kerala (2.5 to 1.92 percent). The decline schemes and adversely affects the social expenditures.
- 2) Increased dependence on centrally sponsored schemes: states have increasingly relied on CSS for welfare spending with expenditure during from 5.21 lakh crore in 2025 -16 to 14.68 lakh crore in 2023-24. This right reduces state autonomy as the funding ratio changed from 40:60 to 50:50.
- 3) Borrowing restrictions: the central government has borrowed around 3 percent of the state domestic product (SDP). This limitation hampers state's ability to raise funds especially during financial crises.
- 4) Implications of goods and services tax: The implementation of GST has completed fiscal federation, leading to revenue shortfalls for states estimated between 19 percent and 33 percent. Delays in compensation payment have further exacerbated cash flow issues.
- 5) Political manipulations of fiscal resources: The central government emphasis on rewarding state aligned with the ruling party hamper equitable development. Opposition ruled states face challenges according central funds, promoting protests against perceived decriminalization.
- 6) Reduce financial transfer: states shares in gross tax revenue have fallen from 35 percent in 2023-24. Additionally, grants -in -aid have declined from 1.95 lakh crore to 1.65 lakh crore during the period.
- 7) Increase in non-devolves cess and surcharge: the share of cess and surcharges which are not shared with state, 5,638 crore in 2015-16 to Rs 3. 63 lakh crore in 2023-24.
- 8) Erosion of state taxation autonomy: The implementation of GST has significantly diminished states ability to set tax rates on their revenue sources as state VAT has been subsumed under GST.

Allocation Budget 2025-26

The union budget indicates that central government's commitment to straightening fiscal federalism and achieving the regional development for which allocation resources were taken in this manner.

Table-I
Gross Transfers from Centre Govt. to States Govt.
Rs in laksh crore

Years	Amount Allocated
2019-20	12.15
2020-21	13.94
2021-22	17.05

2022-23	17.23
2023-24	19.92
2024-25	21.25

Source: Based on RBI report: State Finance: A study of Budgets of Budget of 2024-25.

From the table-I, it is understood that allocation constantly increasing 12.15 to 21.25 from the year of 2019-20 to 2024-25 which is positive signal because the responsibility of states are increasing. Every state government implementing different schemes for welfare of community. Due to this, need of money is required more and more for the states.

Table-II

Allocation and expenditure under the schemes for financial assistance to states for capital expenditure / investment (Rs in crore)

Year	Allocation	Expenditure
2020-21	12,000	11,830.29
2021-22	15,000	14,185.73
2022-23	1,00,000	81,195.35
2023-24	1,30,000	1,09,554.30
2024-25	1,50,000	1,11,001.30

Source: Yojana, March, 2025. Page no.19.

From the table-II, it is understood that gradually increasing allocations 12,000 to 1,50,000 from 2020-21 to 2024-25 which is in the case of allocation of amount. However, in the case of expenditure also increasing is to be found that is 11,830.29 crore to 1, 11,001.30 from the 2020-21 to 2024-25. It shows that allocation as well as expenditure also par ally increasing.

Table-III

**Resources Transferred to States and UT
(In laksh crore)**

Years	Amount Allocated
2022-23	18.65
2023-24	20.65
2024-25	22.76
2025-26	25.60

Source: Yojana, March 2025, Page no.21

From the table-III, it is understood that resources transferred gradually increasing 18.65 lakh to 25.60 lakh crore from 2022 -23 to 2025-26 which indicates responsibilities of states are going on increasing that is why center allocation also increasing.

The budget is built on a four-pillar model designed to enhance fiscal decentralization and empower states. These pillars as follows.

- 1) Enhanced devolution taxes and duties to states.
- 2) Special assistance to states for capital expenditure.
- 3) Higher grant-in aid to states.
- 4) Higher borrowing ceiling to states.

Research Methodology: For testing of hypothesis, 100 respondents were selected throughout telangana state, choosing various districts random wise, categorizing people into students, Govt. Employees, educated, business people and ordinary people following Likert scale system.

Table-IV
Awareness of Fiscal Federalism of Telangana state.

Category	Response for 100 %
1) Educated people	92
2) Govt. Employees	83
3) Business people	76
4) Students	65
5) Ordinary people	48

Source: Survey method.

From the survey, it is understood that 92 percent of educated people, 83 percent of Govt. Employees, 76 percent of business people, 65 percent of students, 48 percent of ordinary people are revealing that allocation of central funds to Telnagana state is very meagre because it is ruling by congress govt. The central government showing partiality towards congress ruled states.

Conclusions

In the case of hypothesis, first hypothesis is accepted because revenue shares are decreasing to Telangana state. Coming to second hypothesis, it is accepted because today Telangana state is not depending on central sponsored schemes. Similarly, third hypothesis is rejected because central borrowing restriction is going on increasing. The central government keeping restrictions more and more that is why state government are facing problems to get borrowing from RBI and other financial institutions.

The progress of the country depends on the federal structure of India which is embedded in the central government's philosophy, with continuous efforts to place states on an equal footing in the nation's development. Prime Minster Naredra Modi emphasized that the importance of aligning governance for regional aspirations and recognizing the vision of 'Viksit Bharat' helps for different states. The union budget 2025-26 which testament to this commitment and reinforcing of India's resolve for both competitive fiscal federalism. The budget certainly helps for stronger, more resilient and self-reliant India.

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