International Journal of Social Science and Economic Research

ISSN: 2455-8834

Volume:07, Issue:06 "June 2022"

ROLE OF FINANCE COMMISSION

Dr. Arif Saeed

Department of political science , R.K. degree college dataganj badaun (U.P.)

DOI: 10.46609/IJSSER.2022.v07i06.021 URL: https://doi.org/10.46609/IJSSER.2022.v07i06.021

Received: 14 June 2022 / Accepted: 25 July 2022 / Published: 8 July 2022

Introduction

Under Article 280(1) of the Constitution of India, the President appointed a Finance Commission on 22nd November 1951 with K.C. Neogy as Chairman and V.P. Menon, Justice R.K. Rao, B.K. Madan as members and M.V. Rangachari as Member-Secretary. The Commission was asked to recommend the basis of distribution of the proceeds of certain taxes between the Union and the States, the principles governing the grants-in-aid to the States out of the Consolidated Fund of India, and the continuation or modification of the terms of any agreement entered into by the Government of India with some State Governments under Article 278(1) and Article 306 of the Constitution. The Commission submitted its report to the Government on 31st December 1952.

Regarding the role of the Finance Commission the Third Finance Commission observed : "The role of the Finance Commission comes to be at best that of an agency to review the forecasts of revenue and expenditure submitted by the states and the acceptance of the revenue element of the plan as indicated by the Planning Commission for determining the quantum of devolution and grants-in-aid to be made; and at worst its function is merely to undertake an arithematical exercise of devolution based on amounts of assistance for each state already settled by the Planning Commission to be made under different heads on the basis of certain principles to be prescribed". Out of these two alternatives, the first will be favoured because the Constitution has provisions for Finance Commission and not for Planning Commission.

The role and working of the Finance Commission is affected with the creation of the Planning Commission. The functions which are supposed to look after by the Finance Commission is appropriated by the Planning Commission despite the fact that the latter is created by the Constitution.

ISSN: 2455-8834

Volume:07, Issue:06 "June 2022"

The Planning Commission began to assume responsibility for the allocation of national resources among different sectors and region of the economy. The Constitution did not anticipate that the Planning Commission would perform functions similar to those of the Finance Commission in respect of allocation of grants.

The Ninth Finance Commission on this issue observed that "the Finance Commission and Planning Commission have independent and distinct roles to play. This is the sphere where the Planning Commission has an important role to play. The Finance Commission is not concerned with it". This means the Finance Commission recognizes the importance of the Planning Commission and so long as the existing arrangement continues the two bodies must work together rather than try to find fault will each other.

A Critique :

The magnitude of financial transfers to the states has increased very much over the plan periods signifying the growing financial dependence of the States on the Union. The transfer of funds to the states through the Planning Commission and other discretionary transfers by the executive authority of the Union taken together has become almost twice the amount of transfers made on the basis of Finance Commissioner's recommendations. The statutory transfers of funds has become less important than the increasing of the Central influences and control over the States as regards their disbursements and consequently it has become a source of criticism that it is a super constitutional body.

Despite the criticism, it must be admitted that ever since the time of the appointment of the First Finance Commission and acceptance of its report by the Union Government, a convention, which has been scrupulously observed, has developed to the effect that the Union Government would act faithfully in terms of the Commission report with regard to the allocation to the States of the net proceeds of the taxes. The critics who have been clamouring in and out of season for constitutional amendments to the fiscal provisions of the Constitution should not underestimate the importance of this trend. Similarly, the Planning Commission, and its offshoot, the National Development Council, an extra constitutional development of unprecedented magnitude, have come to play a pivotal role in the sphere of the fiscal aspect of the Union-State relations. Development Planning, no doubt, has accentuated the scale of public expenditure which have imposed crushing burden on the State's financial position which is not very happy. But the recommendations of the Planning Commission based on its assessment of the states' financial position has obliged the centre to give sizeable amount of money to the states to meet squarely their financial requirements entailed by the implementation of development plans.

ISSN: 2455-8834

Volume:07, Issue:06 "June 2022"

This role of the Planning Commission has contributed in no less a manner to enable the States to get reasonably adequate finances. The advent of the Planning Commission and its role in the formulation of development plan and the resultant impact on the Union-State relations, more particularly adminsitrative and fiscal, constitute the most outstanding development in the theory and practice of Constitutionalism in the post-Constitution period. The critics need not be unduly concerned about the legitimacy of the Planning Commission or its role in the influencing and conditioning the Union-State relations. This kind of concern showing pessimism is understandable in view of the fact that of the two bodies - the Finance Commission and Planning Commission, the latter has come to play more decisive role in the spheres of the Union-State relations.

There is considerable difference between the role of the Finance Commission and that of the Planning Commission in recommending the distribution between the Union and States. No doubt, unlike the Finance Commission, the Planning Commission was brought into being by the executive order of the Union Government.

An Analysis of the Working of Finance Commission :

An analysis of the working of the Finance Commission reveals that it primarily depends on the data supplied by various states. The general nature of the States is to exaggerate their difficulties by manipulating the figures. Thus the absence of an independent cell to collect data continuously has handicapped the working of the Commission. Secondly, the Commission's tour of the State capitals does not provide enough opportunity to make an on the spot study of any of the State projects in progress or in operation.

Only the Third Finance Commission undertook a tour of some of the backward States to assess the adequacy of road communication before recommending special grants for that purpose. Thirdly, all members are not present at all the hearings conducted in the State capitals, because all of them are not full time members and they attend to their personal work as well during their visits. This puts undue strain on the Chairman and the Member Secretary. Fourthly, the failure of the Finance Commissions to publish such details has led the researchers to suspect that they have been trying to avoid informed criticism of their arbitrary assumptions and methods of estimations. The deliberations and findings of the Commission are thus shrouded in mystery. Fifthly, the amount of central resources that the Finance Commission is called upon to distribute among the States is also not determinated by any principle of equity. The Ministry of Finance which decides the amount to be distributed by the Finance Commission keeps a large chunk of

ISSN: 2455-8834

Volume:07, Issue:06 "June 2022"

aggregate resources for its own expenditure and it is not within the competence, of the Finance Commission to question it.

There is a feeling that the Finance Commission has not been given an opportunity to do its best in matters of Union-State financial relations. The Sarkaria Commission which looked into the financial provisions of the Constitution felt that the Finance Commission should take upon itself the role of suggesting changes in the constitutional provisions. However, all the successive eight Commissions have been precluded from this course of action. Though the Finance Commission can suggest changes, yet they are averse to suggesting large scale changes in the federal fiscal arrangements.

The Constitution has not chosen to deviate deliberately from the principles of independence, adequacy and stability. The observance of these principles in shaping the Union-State financial arrangement is not the sole responsibility of the Union. The States should manage their finances in an efficient, imaginative and purposeful manner.

It is the inefficient and maladroit manner in which the States have managed their finances that led to the distortion and multilation of these principles. This should not warrant the conclusion that in the process the principles of independence has been sought to be blurred if not obliterated. The Constitution has followed the established practice of providing the Union and States respectively with independent revenue raising and taxation powers. This is done by following the method of authorising the Union to raise revenue from all such items and sources which are national in character and scope, and the States in respect of such items that are regional or state in scope. But a demarcation like this in the sphere of finance cannot be affected with mathematical accuracy and scientific precision. The logical corollary of this allocation of financial powers between the union and the states is that both have their separate administrative apparatus for collecting their revenues and taxes. The Indian Constitution has done well by conferring both the legislative and administrative authority upon the Union and the States to enable them to exercise effectively their respective fiscal responsibility. By effecting this, the Constitution has not failed to do its best to prevent the cause of fiscal autonomy form being trampled over.

With the enactment of the Constitution, the Union-State financial relations came to be regulated on the basis of the recommendations of a Finance Commission. The setting up of another institution for providing assistance to the states, the Planning Commission, was not envisaged while drafting the Constitution. Over a period of time, a formula-based central plan assistance to the States on the recommendations of the Planning Commission became another major avenue of

ISSN: 2455-8834

Volume:07, Issue:06 "June 2022"

central assistance to the States. Further, centrally-sponsored schemes executed by the States in various sectors are another source of financial assistance to the States. States are also allowed by the RBI, with central approval, to go in for market borrowings to finance their plans. Such proliferation of channels of central assistance to the States has pushed statutory transfers based on the Finance Commission's recommendations to the back-burner with the plan and discretionary transfers hovering in the region of 55-60 per cent. The experience during the last 50 years justifies the need to bring about fundamental changes in the scheme of federal transfers. This issue should engage the attention of the authorities in the context of a burgeoning fiscal deficit.

Vertical Transfers : As per constitutional provisions before the amendment in August 2000, only the income tax and Union excise duty were sharable with the States. Customs duty and corporate tax were not. The divisible pool of the income tax, 50 per cent in 1947, witnessed a steady increase at the hands of each Finance Commission till it reached 85 per cent in 1978, though it was reduced to 77.5 per cent in 1994. In the case of Union excise duty, the divisible pool had a humble start in 1951 at 40 per cent of excise duty on just three selected items - sealed tobacco, matches and vegetable products. This was gradually increased by successive Finance Commissions to 20 per cent of all commodities by the Fourth Finance Commission in 1965.

As the Union excise duty had emerged by then as the most important source of revenue for the Centre (acocunting for 44 per cent of its gross tax revenue), the divisible pool was maintained at this level by the Fifth (1969) and the Sixth Finance Commissions (1973). The Seventh Finance Commission (1977), however, chose to increase the divisible pool to 40 per cent at one stroke. This was further increased to 45 per cent by the Eighth Finance Commission (1984). It is no exaggeration to say that the steep hike in the divisible of pool of Union excise duty is one of the factors responsible for the fiscal imbalances of the Union budget.

Meanwhile, several States started running huge revenue surpluses leading to increased consumption-oriented expenditure and not on capital investment. As the Centre has been following the healthy convention of accepting the recommendations relating to devolution, its options were severely limited. This explained the increased reliance on non-sharable taxes like customs and corporate income tax while maximum relief under personal income tax and Union excise duties became the basic features of the Union budget year after year.

This was well reflected in the devolution, as a percentage of the gross tax revenue of the Centre, declining from 29 per cent in 1978-79 to around 24-25 per cent by 1993-94. It was to correct this phenomenon that the Constitution was amended in 2000 paving the way for making the Central

ISSN: 2455-8834

Volume:07, Issue:06 "June 2022"

taxes sharable with the States. The next step should be to study the behaviour of total Central assistance to the States as percentage of the gross tax revenue receipt over a period of time and arrive at a realistic level of Central transfers keeping in view the committed liabilities of the Centre like defence expenditure, interest payments and pensions. The Twelfth Finance Commission, which would be the first to review the system of fixed percentage of devolution, could undertake this exercise. The role of the Finance Commissions over the last 15 years has become the redistribution of deficits rather than surpluses.

Horizontal Transfers : The horizontal redistribution of devolution and other revenue receipts like additional excise duty in lieu of sales tax among various States is done on the basis of formulae recommended by the Finance Commission. The recommendations of the Eleventh Finance Commission became controversial mainly due to its introduction of the 'fiscal discipline' criterion in the redistribution formula. The only indicator that ensures maximum equity is population. It is unfortunate that weight for this indicator has fallen to 25 per cent from as high as 90 per cent in the earlier Commissions. Population should be assigned a weight not less than 50 per cent. Similarly, there should be some incentive for own tax efforts of States if one believes that god helps those who help themselves.

It would also be necessary for the Finance Commission to discard the time-honoured gap-filling approach, namely, recommending grants to fill the non-plan revenue deficits a practice which kills incentives for tax efforts and encourages fiscal indiscipline on the part of the States. While Argentina and Hungary have abandoned the gap-filling approach, a large federation like Indonesia has carefully avoided such an approach.

Composition of a Finance Commission : According to the Constitution, the Finance Commission should have a Chairman and four members. In the light of the experience gained during the last five decades, particularly the lack of coordination between the Planning and Finance Commissions (despite having a member of the Planning Commission on the Finance Commission), it seems appropriate to make the Deputy Chairman of the Planning Commission concurrently the Chairman of the Finance Commission and Member-in-Charge of resources in the Planning Commission as a member of the Finance Commission. The States should be represented on the Finance Commission as the latter's recommendations directly affect them. For this purpose, a chief minister of one of the major States and another a special category State should be inducted as members. The selection of the individuals could be done through a process of consultation at the Inter-State Council. The Member-Secretary of the Finance Commission could fill the remaining slot. It is high time the Planning Commission is accorded Constitutional

ISSN: 2455-8834

Volume:07, Issue:06 "June 2022"

status. The composition of the Finance Commission could also be incorporated in the Constitution itself.

References

1. P.C. Jain, *Problems in Indian Economics*, Chaitanya Publishing House, Allahabad, 1956, p. 625.
2. K.L. Johar, S.P. Rana, *Centre-State Tension : A Study*, Harman Publishing House, New Delhi, 1990, pp. 36-37.
3. M.J.K. Thavaraj, *Financial Administration in India*, Sultan Chand & Sons, New Delhi, 1991, p. 111.
4. *Ibid*., p. 117.
5. *Report of the Centre-State Relation Enquiry Committee*, Government of Tamil Nadu, 1971, p. 219.
6. M.A. Hussain, *Socio-Legal Perspective of Centre-State Relation in India*, Deep & Deep Publication, New Delhi, 1989, pp. 130-131.
7. *Ibid*., p. 133.
8. *Ibid*., pp. 134-135.
9. *Ibid*., pp. 137-138.
10. K.L. Johar, S.P. and Rana, *Centre-State Tensions : A Study*, Harman Publishing House, New Delhi, 1990, pp. 34-35.
11. *Ibid*.
12. *Ibid*., p. 36.
13. M.A. Hussain, *Socio-Legal Perspective of Centre-State Relation in India*, Deep & Deep Publication, New Delhi, 1989, pp. 151-152.
14. *Ibid*., pp. 30-31.
15. *The Hindustan Times*, 25 April, 2003, p. 12.
16. *Ibid*.
17. *Ibid*.
18. *Ibid*.
19. *Ibid*.

