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ROLE AND IMPORTANCE OF FINANCIAL COMMISSION IN FEDERAL SYSTEM OF INDIA

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ABSTRACT

The present study focused on the Centre-State relationship. The Centre-State relations can be studied under three heads; legislative, administrative and financial relations. The paper mainly focused on financial relations between both Centre and state. The Centre–State financial relations are based on the principles of federal finance. All sources of income and expenditure stand distributed amongst the Union government, state government and local governments, in the form of three lists viz; Union list, Concurrent list and State list. For this purpose, Indian constitution provides Finance Commission in the country for the maintenance of financial system between Centre and states under Article 280 (Part 12th). Transfer of resources from the central government to the states is an essential feature of the Indian financial system. The paper also throws light on the functions and responsibilities between the Finance Commission and the Planning Commission in federal structural of India.

KEYWORDS: Federation, Centre-State Relations, Finance Commission and Planning Commission

INTRODUCTION

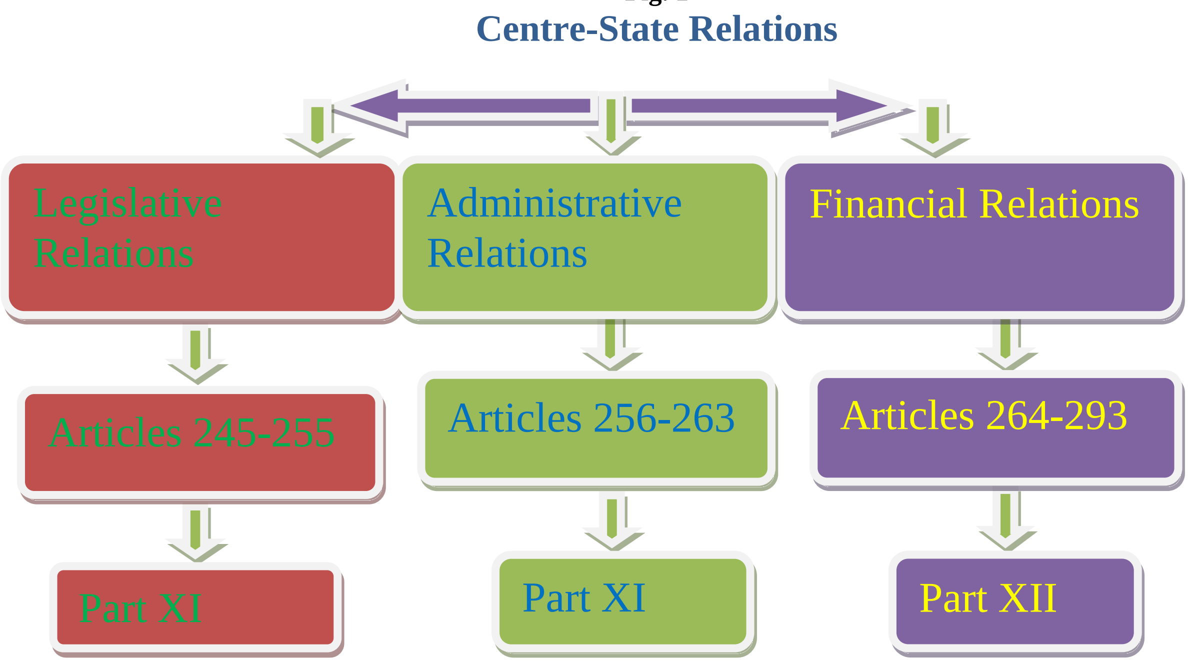
Article 1 of the Indian constitution describes India, that is, Bharat as a 'Union of States' rather than a 'Federation of States.' The word federation connotes the Union of two or more states. In a federation, the federal government functions at the national level and the state level. Federation may be defined as a, "form of political association in which two or more states constitute a political unity with a common government, but in which these member states retain a measure of internal autonomy". The same view has also been upheld by Eminent of Indian Jurist Dr. AbhishekSinghvi as federalism being "a sense of devolution of power and the sharing of decision making authority between at least two, if not more, institutions of governance".

India is described as Union of States although its constitution is federal in structure divides all powers (Legislative, Executive and Financial) between the Centre and states. In the words of Dr. BR Ambedkar, the phrase Union of States has been preferred to federation of states for two reasons; first, the Indian federation is not the result of an agreement among the states like the Amrican federation; and second, the states have no rights to secede from the federation. The federation is a Union because it is indestructible. The country is an integral whole and divided into different states only for the convenience of administration. Transfer of resources from the Central government to the states is an important feature of the present financial system of India.

"We want to promote co-operative federalism in the country. At the same time, we want a competitive element among the states. I call this new form of federalism Co-operative and Competitive Federalism". (Prime Minister NarendraModi)

In India, the division of functions between the Centre and the states is the result of fairly a long process of evolution. There are three lists (Union list, State list and Concurrent list) in the constitution. The Union government has to perform hundred (originally 97) subjects including defence of India, foreign affairs, war and peace, passports and visas, railways, National highways, shipping and extradition and so on. Sixty one (originally 66) subjects have been assigned to state governments including public order, relief of the disabled and unemployable, fisheries, trade and commerce within the state, land revenue (including maintenance of land records), taxes on land and buildings etc. The Concurrent list includes fifty two (originally 47) subjects such as criminal law (including all matters included in the Indian Panel Code (IPC), education, forests, criminal procedure, removal from one state to another state of prisoners or accused persons, trust and trustees etc. The 42nd Amendment Act of 1976 transferred five subjects to Concurrent list from State list, i.e (a) education, (b) forests, (c) weights and measures, (d) protection of wild animals and birds and (e) administration of justice; constitution and organization of all courts except the Supreme Court and High Courts.

The Centre-State Relations can be studied under Three Heads
Fig. 1



The distribution of powers between the Union and the states is provided in the constitution itself in a very detailed manner. The legislative, administrative and financial powers are distributed under the constitution of India and also Centre-State Trade and Commerce relation under Article 301-307. However, there is no division of judicial powers as the constitution has established an integrated judicial system (Supreme Court) to enforce both central laws as well as the state laws. Though the Centre and the states are supreme in their respective fields, the maximum agreement and co-ordination between them is essential for the effective operation of the federal system. Hence, the constitution contains the elaborate provisions to regulate the various dimensions of the relation between the Centre and the states.

In 1983, the central government appointed a three member commission on Centre-State relations under the Chairmanship of R. S Sarkaria a retired judge of the Supreme Court. B. Sivaraman and S. R Sen were two other members of the commission. The commission was asked to examine and review the working of existing arrangements between Centre-State in all spheres and recommend appropriate changes and measures. The commission made 247 recommendations to improve Centre-State relations. A new commission on Centre-State relations was set up by the government of India in April 2007 under the Chairmanship of Madan Mohan Punchi, former Chief justice of India.

OBJECTIVES OF THE RESEARCH WORK

To highlight the Centre-State relationship; with special reference financial relations.

To stress on the role and importance of the Finance Commission appointed so far in India and to analyze their working is the constitutional body for federal devolution of resources in India.

To highlight the functions and duties of the Finance Commissions in federal system of India.

FINANCIAL RELATIONS

The history of financial relations between the Centre and the states in India is about a hundred years old. But, as is well known, the Indian states "had remained outside the fiscal and financial systems of the rest of the country except for certain arrangements entered into with them by the government of India regarding such matters as maritime customs, central excises, posts and telegraphs and railways". Before independence, the division of taxing powers was such that federations and the states resources were viable and sufficient for their functional need. The states had developing and elastic powers of revenue and there were no need for the federation to give grants to the states for administration or specific purposes though the federation was given enumerable powers. With the passage of time, the changes in economic conditions lead to distortions of original stability and resulting balance of power is bound to be stated in favour of one government or other. In the circumstances the conditions were changing just from time to time the device should be flexible. In the words of D R Gadgil; "the problem of federal finance is thus that of maintaining through changing circumstances, needed correspondence between functions and resources without the use of coercive power". The Centre levied only a few taxes, namely the customs, central excise, taxes on income and salt duty. The bulk of central tax revenue came from customs duty. India had no independent taxation policy of its own during that period. The taxation policy pursued in Great Britain was adopted in India. During that period, the most important commodity taxation which yielded about 60 percent of the total central tax revenue was custom duties. It was in 1871, that some decentralization of finances was granted by Lord Mayo, the then Governor-General of India. Powers under certain heads, such as police, jails, registration, roads, education and medical services etc were devolved on the provinces. This decentralization of power was not based on any financial principle, and still the ultimate financial control was vested with the central government.

After independence taxation can be divided into three main heads, viz. the property taxation, the taxation of corporate income and the commodity taxation. Due to independence, there was no definite change in any tax. However, the independence changed the percentage shares of income tax to be distributed among the provinces. The distribution of income–tax proceeds among the provinces was made on the basis of "Nieymes Award". But in August 1947, the percentage share of different provinces were slightly changed or shuffled so as to adjust to the changes which were caused in the geography of the country by partition. With a view to bring about administrative convenience minor changes were effected in the rate of custom duties. Independence did not bring about any immediate change in the policy of protection for the industries of the country. The Tariff Board was however, reconstituted in November 1947. The Board completed its investigation and submitted the report to the government of India.

3.1 Articles 268-279 Dealing with Distribution of Revenues between the Union and the States

- Article 268: Duties levied by the Union but collected and appropriated by the states.
- Article 269: Duties levied by the Union but collected and appropriated by the states.
- Article 270: Taxes levied and distributed between the Union and the states.
- Article 271: Surcharge on certain duties and taxes for purposes of the Union.
- Article 272: Taxes which are levied and collected by the Union and may be distributed between the Union and the states.
- Article 273: Grants in lieu of export duty on jute and jute products.
- Article 274: Prior recommendation of President required to bills affecting taxation in which states are interested.
- Article 275: Grants from the Union to certain states.
- Article 276: Taxes on professions, trades, callings and employments.
- Article 277: Savings.
- Article 278: Agreement with states in Part B of the 1st Schedule with regard to certain financial matters.
- Article 279: Calculation of "net proceeds", etc.

Finance Ministers of India since Independence (1947) Till Date

Table 1

S. NO	Name	Party	Tenure
1	R. K Shamnukham	INC	August 15, 1947 – 1949
2	JhonMathai	INC	1949 – 1950
3	C. D Deshmukh	INC	1950 – 1957
4	T. T Krishmachari	INC	1957 – Feb 1958
5	J. L Nehru	INC	Feb 13, 1958 – Mar 13, 1958
6	Moraji Desai	INC	Mar 13, 1958 – Aug 29, 1963
7	T. T Krishmachari	INC	Aug 29, 1963 – 1965
8	SachindraChoudhary	INC	1965 – Mar 13, 1967
9	Moraji Desai	INC	Mar 13, 1967 – Jul 16, 1969
10	Indira Gandhi	INC	1970 – 1971
11	Y. B Chavan	INC	1971 – 1975
12	C. Subramaniam	INC	1975 – 1977
13	H. M Patel	BJP	Mar 24, 1977 – Jan 24, 1979
14	Charan Singh	BJP	Jan 24, 1979 – Jul 28, 1979
15	H. N Bahugane	BJP	Jul 28, 1979 – Jan 14, 1980
16	R. Vankataraman	INC	Jan 14, 1980 – Jan 15, 1982
17	PranabMukharjee	INC	Jan 15, 1982 – Dec 31, 1984
18	V. P. Singh	INC	Dec 31, 1984 – Jan 24, 1987
19	Rajive Gandhi	INC	Jan 24, 1987 – Jul 25, 1987
20	N. D Tiwari	INC	Jul 25, 1987 – Jan 25, 1988
21	S. B Chavan		Jun 25, 1988 – Dec 2, 1989
22	MadhuDandavate	JD	Dec 2, 1989 –Nov 10, 1990
23	Yashwant Singh	SJP	Nov 10, 1990 – Jun 21, 1991
24	Dr. Manmohan Singh	INC	Jun 21, 1991 – May 16, 1996
25	Jaswant Singh	BJP	May 16, 1996 – Jun 1, 1996
26	P. Chidambaram	TMC	Jun 1, 1996 – Apr 21, 1997
27	I. K Gujral	JD	Apr 21, 1997 – May 1, 1997
28	P. Chidambaram	TMC	May 1, 1997 – Mar 19, 1998
29	Yashwant Singh	BJP	Mar 19, 1998 – Jul 1, 2002
30	Jaswant Singh	BJP	Jul 1, 2002 – May 22, 2004
31	P. Chidambaram	INC	May 22, 2004 – Nov 30, 2008
32	Dr. Manmohan Singh	INC	Nov 30, 2008 – Jan 24 – 2009
33	PranabMukharjee	INC	Jan 24, 2009 – Jun 26, 2012
34	Dr. Manmohan Singh	INC	Jun 26, 2012 - Jul 31, 2012
35	P. Chidambaram	INC	Jul 31, 2012 – May 16, 2014
36	ArunJaitly	BJP	May 16, 2014 – till date

Sources: https://en.wikipedia.org/wiki/Minister_of_Finance_%28India%29

FINANCIAL POWERS AND FUNCTIONS OF THE INDIAN PRESIDENT

The financial powers and functions of the President are:

- Money bills can be introduced in the parliament only with his prior recommendation.
- President causes to be laid before the parliament the annual financial statement (i.e the Union budget).
- No demand for a grant can be made except on his recommendation.
- President can make advances out of the contingency fund of India to meet any unforeseen expenditure.
- He constitutes a Finance Commission after every five years to recommend the distribution of revenues between the Centre and the state.

FINANCE COMMISSION

The Finance Commission of India came into existence on November 22, 1951. The first such commission was constituted on November 19, 1951 headed by KC Neogy. It was formed to define the financial relations between the Centre and the state. The Finance Commission Act of 1951 states the terms of qualification, appointment and disqualification, the term, eligibility and powers of the Finance Commission. The

Finance Commission has been provided for by the Indian constitution as part of the scheme of division of financial resources between the two different sets of governments. The Finance Commission as an autonomous body has served a splendid purpose. In as complex polity in India, it acted as an agency to bring about co-ordination and co-operation that is so important in the working of a federal system.

i The role of Finance Commission in India is to act as an instrument to divide proceeds of divisible taxes between the states and the Union government or in cases of taxes that are collected by the Centre but the proceeds of which are allocated between the states, to determine the principles of such allocation.

ii The Finance Commission of India also determines the principles of governing the grants-¬in-aids of the revenues of states out of the consolidated fund of India. It is an important function of the Indian Finance Commission.

iii Thirdly the Finance Commission has the duty of considering any matter referred to the commission by the President in the interest of sound finance.

Finance Commission is appointed every five years in order to make allocation of shared taxes and grants-in-aid under Article 275 and to undertake a fiscal review of inter governmental financial institutions. It is difficult to have exact clean separation of finances for the different layers of government. The federal state fiscal relation in India is much more complex as compared to other major federations. In other, federation has not been found possible to provide for allocation of resources to correspond with allocation of functions. Its recommendation must be taken into account in deciding the grants-in-aid of the state's revenue; the sharing of the taxes and other matters referred to it. Most federal systems resolve the fiscal imbalances through mechanisms similar to the Finance Commission. For example, Australia and Canada have systems similar to India's Finance Commission. Indian Finance Commission is unique in many ways. It is one of the commissions provided in the constitution. It has no parallel in established federal constitutions. In the words of Lakdawala; "The Finance Commission is expected to play a role of wise man, a judge between the conflicting claims of the states, on the one hand, and the Centre on the other".

Indian Finance Commission consists of a Chairman and has four other members, are appointed by the President under Article 280 of the constitution is the main agency for effecting such transfers. They hold office for such period as specified by the President in his order. Parliament may by law determine the qualifications which shall be requisite for appointment as members of the commission and the manner in which they shall be selected. The Chairman is to be a person having experience in public affairs and the four other members are to be selected from among persons; qualified to be appointed as the judges of a High Court, or having special knowledge of the finances and accounts of the government; or having wide experience in financial matters and in administration; or having special knowledge of economics. The Finance Commission has the status and power of a civil court. It is an advisory body and the President is not bound to accept its recommendations. It is to the great credit of the Finance Commission that the government of India has treated the commission with great respect. Out of the various recommendations made by the Finance Commission, most of the recommendations are accepted by the Centre.

Article 280 has left to the parliament the power to prescribe the qualification of the Chairman and other members of the Finance Commission, as also the procedures for their appointment and for the work of the Finance Commission. The tenure of Chairman shall be fixed by the President and shall be eligible for reappointment. The members shall render whole-time or part-time service as the President may specify. The constitutional provision requires that the President should appoint the Finance Commission within two years from the commencement of the constitution and thereafter once in every five years and earlier, if it is necessary. Finance Commission under Article 280 of the constitution, primarily to recommend measures and methods on how revenues, which the government earns through various taxes, need to be distributed between the Centre and states.

Since the institution of the first Finance Commission, stark changes have occurred in the Indian economy causing changes in the macro-economic scenario. This has led to major changes in the Finance Commission's recommendations over the years. Till date, fourteen Finance Commissions have been constituted. The name of the Commission, the year in which they were constituted and submitted that their reports and the name of the Chairman are given in Table 2.

F Commission	Year	Chairman	Duration
1^{st}	1951	K. C. Neogy	1952 – 1957
2^{nd}	1956	K. Shanthanam	1957 – 1962
3^{rd}	1960	A. K. Chando	1962 – 1966
4^{th}	1964	P. V. Rajmanner	1966 – 1969
5^{th}	1968	MahaveerTyagi	1969 – 1974
6^{th}	1972	K. B. Reddy	1974 – 1979
7^{th}	1977	J. M. Shalate	1979 – 1984
8^{th}	1983	Y. B. Chavan	1984 - 1989
9^{th}	1987	N. K. P. Salve	1989 –

			1995
10th	1992	K. C. Pant	1995 – 2000
11th	1998	A. M. Khusro	2000 – 2005
12th	2002	C. Rangarajan	2005 – 2010
13th	2007	Dr. Vijay Kelkar	2010 – 2015
14th	2013	Dr. Y. V. Reddy	2015 – 2020
15th	2017	N. K Singh	2020-2025

Source: https://en.wikipedia.org/wiki/Finance_Commission

The temporary character of Finance Commissions necessitates that each time a Finance Commission is constituted all administrative and infrastructural arrangements such as hiring of office building, appointment of personnel, procurement of equipment etc are made afresh. It also necessitates that each commission collects data and information afresh due to which considerable time lapses before the commission can start functioning in an effective manner.

It is the duty of the commission to make recommendations to the government on the distribution of net tax revenues between the Centre and states and also the allocation of the respective shares of such proceeds to the states. This is the most important task of any Finance Commission, as the share of states in the net proceeds of Union taxes is the predominant channel of resource transfer from the Centre to states. The Finance Commission is also mandated to recommend measures to govern the grants-in-aid of the revenues of the states out of the Consolidated Fund of India (CFI). The commission in addition to the fiscal need grants also recommends specific purpose grants. Besides, it recommends measures needed to augment the Consolidated Fund of a state to supplement the resources of Panchayats in the state on the basis of the recommendations made by the respective state Finance Commissions. In addition, it is the mandate of the Finance Commission to recommend measures needed to boost the Consolidated Fund of a state to supplement the resources of municipalities in the state. Article 280 specified broadly the terms of reference of the Finance Commission under clause 3(a), 3 (b) and 3 (c) to be determined by the President depending upon the need for such references. The functions of the commission, as prescribed by Article 280 are to make recommendations to the President with regard to;

a The distribution between the Union and the states of the net proceeds of taxes which are to be, or may be, divided between them under this Chapter (Part XII and Chapter 1st) and the allocation between the states of the respective shares of such proceeds;

b The principles which should govern the grants-in-aid of the revenues of the states out of the Consolidated Fund of India (CFI);

c The measures needed to augment the Consolidated Fund of a State to supplement the resources of the Panchayats in the state on the basis of the recommendations made by the Finance Commission of the state;

d The measures needed to augment the Consolidated Fund of a state to supplement the resources of the Municipalities in the state on the basis of the recommendations made by the Finance Commission of the state;

e Any other matter referred to the Commission by the President in the interests of sound finance.

The recommendations made by Finance Commission are only advisory in nature and hence, are not binding on the government. The recommendations of the commission makes ultimately find their destination under Article 281 in being laid before each house of parliament (LokSabha and RajiyaSabha). The hope is that the nature of the Finance Commission, its quasi-judicial method and its eminent and experienced personnel will command spontaneous respect. Its recommendations would be considered except matter for strong reasons with unanimity. Dr B N Rau rightly said for Finance Commission as “a quasi-arbitral body whose function is to do justice between the Centre and the states”. The duty of the commission and with the making of recommendations, the acceptance of which rests with the President or with parliament which has to enact laws in reference to them in the matters prescribed by Article 270, 272 and 275.

Till 1960, the commission also suggested the amount paid to the states of Assam, Bihar, Orissa and West Bengal in lieu of assignment of any share of the net proceeds in each year of export duty on jute and other products. The Indian constitution envisages Finance Commission as the balancing wheel of the federalism in India. However, its role in the Centre-State fiscal relations has been undermined by the emergence of the Planning Commission, a non-constitutional and a non-statutory body.

Dr P. V. Rajmanner, the Chairman of the 4th Finance Commission, highlighted the overlapping of functions and responsibilities between the Finance Commission and the Planning Commission in federal fiscal transfers in the following way:

It is the setting up of the Planning Commission that has in practice restricted the scope and functions of the Finance Commission. He says ‘in practice’ because there has been no amendment of the constitution to confine the functions of the Finance Commission to merely ascertain and cover the revenue gap of each state, on a review of the forecast of revenue and expenditure furnished by the state. The reference in Article 275 to grants-in-aid to the revenues of states is not confined to revenue expenditure only. There is no legal warrant for excluding from the scope of the Finance Commission all capital grants; even the capital requirements of a state may be properly met by grants-in-aid under Article 275, made on the recommendations of the Finance Commission. The legal position, therefore, is that there is nothing in the constitution to prevent the Finance Commission from taking into consideration both capital and revenue requirements of the states in formulating a scheme of devolution and in recommending grants under Article 275 of the constitution. But the setting up of Planning Commission unavoidably has led to a duplication and overlapping of functions, to avoid which a practice has grown which has resulted in the decrease of the functions of the Finance Commission. As the entire plan, with regard to both policy and programme, comes within the purview of the Planning Commission and as the assistance to be given by the Centre for plan projects either by way of grants or loans is practically dependent on the recommendations of the Planning Commission, it is obvious that a body like the Finance Commission cannot operate in the same field. The main functions of the Finance Commission now consist in determining the revenue gap of each state and providing for filling up the gap by a scheme of devolution, partly by a distribution of taxes and duties and partly by grants-in-aid. We, therefore, recommend that in future the Finance Commission may be asked to make recommendations on the principles which should govern the distribution of plan grants to the states. In order that the Finance Commission may be able to make such recommendations, it will be necessary that it should have before it an outline of the Five Year Plan (FYP) as prepared by the Planning Commission. The appointment of the Finance Commission will, therefore, have to be so timed that it will have before it this outline before it finalizes its recommendations.

RESEARCH METHODOLOGY

The study is mainly based upon the collection of secondary data. Secondary data have been collected from various interim and annual reports presented to the Ministry of Finance, Govt. of India. In addition to this, data have been collected from various journals, articles, research papers archives. The research is also based on the referred sources; published, unpublished and electronics etc.

CONCLUSION

To conclude, therefore, the dictates of planned development have severely restricted the scope of the Finance Commission to function as an impartial and high power body to regulate financial relations between the Centre and the states, which was the role assigned to it by the constitution makers. Its functions have now been largely taken over by the Planning Commission. The Planning Commission is the creation of the Central government and their executives. But the significant is that in the field of resource transfer Planning Commission distributes about 75 percent of the total devolution whereas Finance Commission being a statutory body recommends only 25 percent of the resource transfer. The Finance Commissions work may equally efficiently carried out by a department of the Planning Commission.

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