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Center-State Financial Relation and Role of Finance Commission: A Study

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Introduction:

India is a federation with a parliamentary system governed under the Constitution of India, in which the parliamentary form of government is federal with unitary features and provides for the Center (Union) and the States. It defines the structure, organization and powers of the Central as well as State Governments; And there is a clear division of powers between the Center and the States through three lists namely Union List I, State List II and Concurrent List III. The Constitution provides for the independence of the judiciary, the Comptroller and Auditor General, the Public Service Commission and the Chief Election Commission.Fiscal federalism refers to the financial relationship between units of government in a federal system of government. It deals with the division of government functions and economic relations between levels of government. It is a major aspect of the country's federal relations.

In India, a constitutionally mandated body at the heart of fiscal federalism is the Finance Commission. The Finance Commission has played an important role in securing the foundations of fiscal federalism in recent times. The Finance Commission makes its recommendations regarding the distribution of tax revenue between the Center and the States and within the States themselves.The Finance Commission is a constitutionally constituted, independent body. It determines the ways and formula of distribution of tax revenue between the Center and the States and among the States. According to Article 280 of the Constitution, the President of India is required to constitute a Finance Commission every 5 years. The Finance Commission is set up to get suggestions on the distribution of tax revenue. According to the constitution, the Finance Commission must consist of a chairman and four other members who are experts in the field. The Fifteenth Finance Commission, was set up in 2017 and will perform its duties from 2020 to 2025 under the chairmanship of NK Singh.

Evolution of Centre-States Relations:

The present federal financial system did not develop in a day or two but over a long period of time since the late eighteenth century. The Government of India Act-1919 is a landmark in the history of the evolution of fiscal federalism in India. The Government of India Act-1935 established a clear demarcation between the Centre, the States and the subjects falling under both the Center and the States. After India's independence, the Seventh Schedule of the Constitution of India fundamentally changed India's federal status by clearly dividing financial powers and expenditure responsibilities between the central and state governments. Over the last 60 years, the Indian Federation has incorporated many changes through various constitutional amendments, changes in criteria for transfer of resources, etc. to meet the objectives of fiscal federalism, i.e., reducing fiscal imbalances and ensuring equal level of public provision, Services like education, health etc. at the same rate in all states.

Distribution of Legislative Powers (Subject Matter):

As mentioned at the outset, a federal system determines the distribution of powers between the center and the states. The nature of distribution varies according to the local and political background in each country. In America, sovereign states do not like complete subordination to the central government. Therefore, he believed in keeping the remaining subjects with him and handing over the subjects of common interest to the central government. Australia followed the American pattern of only one force calculation. In Canada, there is federal and provincial double counting, leaving the remainder for the center. Canadians were aware of the unfortunate events in the United States of America, which led to the Civil War of 1891. He was aware of the shortcomings of a weak center. So, they chose a strong center. The Indian constitution makers followed the Canadian plan and opted for a clearly strong center. However, they added another list - the concurrent list.

With regard to matters of law, the Constitution adopts from the Government of India Act, 1935 and divides the powers between the Center and the States according to the three lists. They are as follows: (i) Central List (ii) State List and (iii) Concurrent List

A)Center List: Currently the Center List includes 99 subjects on which the Union will have exclusive power to legislate. Subjects mentioned in the Central List are of national importance, for example, defense and foreign affairs etc.

B) State List: The State List contains 61 subjects over which the States have exclusive power to legislate. Subjects mentioned in the State List are of local or regional importance, such as public order, police and public health etc.

C) The ConcurrentList: The ConcurrentList includes 52 subjects and both the Center and the States can make laws on this list but in case of conflict between the Central Law and the State Law, the Central Law will prevail over the State Law. The purpose of adding the list to the Constitution was to maintain uniformity in the main principles of law throughout the country.

Issues Between Centre and States

The Constitution of India was adopted on 26 November 1949 and came into force on 26 January 1950. Our Constitution is universally believed to be an organic living institution. It is flexible, designed to meet the needs and requirements of a rapidly changing and rapidly evolving society. The federal system of government is extensively discussed in the various articles of the constitution that outline and determine the relationship between the central and state governments. Events during the partition of the country before the birth of independent India led the Constituent Assembly to opt for a "federation of states" with a strong center, away from the idea of a loose federation that had captured India's attention. In the last six decades since the Constitution came into force, there have been 95 amendments, many of which have had a direct impact on Centre-State relations.

After economic reforms began in 1991, the responsibility of states to meet the growing needs of the people for basic services has greatly increased. Over the years, the Center has become stronger in terms of higher revenue potential, while states have been burdened with more functional responsibilities in the areas of education, health, economic and social infrastructure, social security and welfare. This has led to an increase in vertical fiscal imbalances and horizontal fiscal imbalances due to the differential performance of states in the post-reform period. As a result, there has been an increase in disparities between and among states in terms of public service delivery. Further, the implementation of the Fiscal Responsibility and Budget Management Act (FRBMA) by the Center directing states to bring discipline to public finance management has increased pressure to improve the productive assets of poorer states in particular. Although fiscal discipline is essential, the share of capital expenditure has declined in most states, particularly backward states. States are increasingly dependent on market borrowing as central loans to states reduce tenure but increase borrowing costs and further increase state debt burden.

Role of The Finance Commission:

In India, the Finance Commission was established with the main responsibility of assessing the financial position of the central and state governments, deciding on the mode of distribution of taxes and formulating guidelines for distribution of taxes among the states. The role of the Finance Commission includes effective coordination with all levels of government to take decisions and thus strengthen the structure of fiscal federalism. The commission's recommendations aim to balance public expenditure between the central and state governments. The need for a Finance Commission is important as it takes care of the issues of financial relations between the Central and State Governments.

Article 280 of the Constitution provides for the constitution of a Finance Commission to recommend to the President every five year. The Finance Commission is a constitutional body established by the President of India to advise on Centre-State financial relations. The Finance Commission is a quasi-judicial constitutional body established under Article 280 of the Constitution of India. It was established in the year 1951 for proper financial arrangement between the central and state governments of India. Also, by sharing a portion of revenue resources between the central and state governments, the Finance Commission intends to reduce fiscal imbalances between the central and state governments (vertical imbalances) and between states (horizontal imbalances). Article 280(1) provides for appointment of Finance Commission every five years or earlier if deemed necessary by the President of India. The commission consists of a chairman and four other members appointed by the president. Parliament legally determines the qualifications of members and their selection process. Shri NK Singh is the Chairman of the current 15th Finance Commission for the period 2020 to 2025 and other members are Ajay Narayan Jha, Anoop Singh, Ashok Lahiri, Ramesh Chand, Arvind Mehta. Parliament is empowered to decide under Article 280(2) of the Act, the necessary qualifications for appointment as members of the Commission. Article 280(3) provides for the functions of the Finance Commission, namely to make recommendations to the President in respect of the following matters:

a)Distribution of net income from taxes to the Central and State Governments and also to the States.

b) Principles governing grant of revenue to States from the Consolidation Fund of India.

c)The Commission shall have such powers as the Parliament may by law provide in any other matter referred to it by the President in the interests of sound finance Article 280(4).

The role of the Finance Commission as the apex body is to control the allocation and distribution of fiscal powers while addressing issues related to imbalances and disparities. Some states have inadequate access to resources due to territorial limitations. Keeping this situation in mind, it recommends guidelines regarding the extent of central funds to be shared by the states. The various roles of the Finance Commission in the Federal Government include the following:

1.Tax Revenue Sharing- The commission recommends sharing of central taxes with states based on certain equitable criteria to reduce disparity among states, which is essential for fiscal federalism. The parameters of tax sharing are as follows:

- **Population:** Expenditure needs of a state are indicated by its population.
- **Area:** The administrative expenditure incurred by the State shall be in proportion to its area.
- **Per Capita Income**: States with lower per capita income will be eligible to receive higher tax allocations and subsidies.
- **Economic developments:** Some states may have greater coverage of agricultural land or forests, which limits opportunities for other economic activities and may therefore be given a higher share.

2. Handling Horizontal Imbalance -The Finance Commission plays an important role in removing imbalances arising out of differences in the extent of financial benefits enjoyed by various states. It reviews the growth rate and development status of various states and assesses capital requirements.

3. Addressing Vertical Imbalance - The tax collected by the central government covers a large area. State governments spend heavily on developing social and economic sectors at the sub-national level. The role of the Finance Commission is to provide mechanisms in the form of shared tax revenue and grants as needed.

4. Review and Progress - An important role of the Finance Commission is to review the impact of the recommendations made by the previous Finance Commission. A Finance Commission is needed to review the financial position of the Central and State Governments and recommend a roadmap for reforms and progress. The impact of new taxes at the central and state levels and on the economy is also studied.

Conclusion:

In the era of transition from a centrally planned economy to a market economy, it has become necessary to recognize the challenges faced by policymakers in the federal political structure at the Center and the states. Economic federalism and coordinated reform processes at all levels of government are key tools for accelerating growth, reducing poverty, eliminating disparities and ensuring human development. Such efforts will help offset the handicaps and losses of new and smaller states. Given the political advantages of a strong and stable central government, the central government may at times be tempted to control some of the state governments by centralizing the matters mentioned in the Concurrent List. States cannot do much to correct this anomaly, but of course the responsibility for reform lies with the central government.

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