Centre-States Financial Relations

Role of Finance Commission

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The Articles relating to the powers and functions of the Finance Commission in the Constitution are substantially the same as Sections 138, 140 and 142 of the Government of India Act, 1935. Yet throughout the fifties the traditional approach to problems of financial adjustment between the Centre and the States was gradually getting out of date. The financial integration of the country has now reached a stage which could not have been visualised when the Constitution was framed. The Finance Ministers of the States have today only a few of the freedoms that their counterparts enjoyed even a decade ago. Take any State budget. It has two parts: the 'normal' budget including the 'committed' expenditure for the Plan schemes, and the Plan budget consisting of the annual plan of the State. Both receipt and expenditure sides of the Plan budget are determined in advance in course of discussions with the Planning Commission. The 'normal' budget is also determined simultaneously. Thus the budget that the State Finance Minister presents to the Assembly is basically nothing but what was drawn up earlier during discussions with the Planning Commission. The State Finance Minister can neither propose any new item of expenditure nor draw upon any new source of revenue from which to finance such expenditure. Almost everything is predetermined.

This fact of financial integration is a matter of fundamental significance for the institution of the Finance Commission. Shared taxes as an instrument for effecting financial adjustment between the Centre and the States have lost their importance. Unlike in Australia and Canada the States in India have no special claim on the shared taxes. The Indian Constitution has placed them different names. Of course, through the shared taxes the States benefit from the elastic resources of the Centre, but the element of elasticity can as well be made a built-in element of grants-in-aid. The grants-in-aid can, for instance, be tagged on to the index-number of increase of certain Central revenues.

Limited Scope for Finance Commission

If it is granted that the formulation of the principles of distribution of shared taxes has become an unnecessary function, the main task that remains for the Finance Commission is to assess the needs of the States so that grants-in-aid from the Centre can be distributed accordingly. This task requires consideration of all aspects of the State's economy. Information required for such an assessment continuously flows to the Planning Commission. Analysis of these data is constantly carried out by the Planning Commission and by Central ministries which work in union with the Planning Commission. The possibility of the Finance Commission gathering new data or securing new results from the analysis of available data arc therefore very remote.

In the section entitled 'Planning and Finance Commission', the Report of the Second Finance Commission states that their work in assessing the budgetary needs of the States consisted mainly of bringing the estimates prepared by the Planning Commission up-to-date. In the section on Assessment of Needs of States the Report states how the Commission had to make only certain accounting adjustments in the estimates prepared by the Planning Commission and the States to calculate the budgetary gap of the States. With regard to evaluating the States' efforts to intensify their tax efforts and effect economy in their expenditure, the Second Finance Commission could make no independent assessment and had to rely on the estimates presented by the Planning Commission.

The Second Finance Commission suggested that the long time-lag between the finalisation of a Five-Year Plan and the setting up of the Finance Commission should be reduced. This suggestion seems to have been given effect to in appointing the Third Finance Commission. The States have already been asked to submit forecasts of their receipts and expenditures for next five years by December 15, 1960. Inevitably therefore, the needs of the States as assessed by the Finance Commission will be more or less identical with the estimates made by the Planning Commission.

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. In the narrow and limited sphere left to it, the Finance Commission's work may equally efficiently be carried out by a department of the Planning Commission or a Committee of the Rajya Sabha or, indeed, by the National Development Council.
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