FOURTEENTH FINANCE COMMISSION:-A STEP TOWARD FEDERALISM OR NOT

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ABSTRACT

The Finance Commission is a body of Constitution which recommends on the distribution of revenue generated between federal government and state government. But a federal country like India, principle of equality demands that the citizens living in different geographical territories to raise their own revenues should be capable of enjoying minimum amount of services and revenues. The diversity is the main reason behind the concept of fiscal transfer to the states rather than the centre. The traditional principles of federal finance are rationale behind constitutional provisions for Finance Commission and criteria for devolution for funds.The Constitution of India provides for the complete separation of taxing power between both level of government that is state government and centre government. With the passage of time the framers realized that the position of the states can be enhanced only by providing a mechanism for the transfer of central resources to the states so finance commission was created. The most important feature of it is that it can be reviewed periodically and it worked automatically without any inter governmental friction. Finance Commission is set up under Article 280 of the Constitution. It also laid down the principles for providing grant in aid to states besides its main function. In the case of 14th Commission, the principles laid out by them will apply for a five-year period beginning April 1, 2015.It has recommended an increase in the share of states in the centre's tax revenue from 32 per cent to 42 per cent which is indeed the single largest increase ever recommended by a Finance Commission. So the working of Finance Commission has been reviewed in this research paper to maintain the fiscal federalism in India over the period of time.

Keywords:-Federalism,Finance Commission,Grant-in-aids,Transfer of Resources

INTRODUCTION:-

One of the complex area of our economic system is to formulate and implement an intergovernmental plans & policies. So if we look into India's federal system, the financial or fiscal transfer to states is regulated by three body which consists of Planning Commission, Finance Commission and Central Ministeries. There exist vertical imbalance and horizontal financial imbalance in India which can be addressed by Finance Commission and that's the reason why they are that much significant to our country. Now, the measurement of financial imbalance exist between central and State Government is called vertical imbalance while measuring imbalance between Government at the same level is called horizontal imbalance.Now,the state

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gets its largest share only through the Finance Commission. Now, the main question is What is Finance Commission?

According to Article 280 of the Indian Constitution, it is stated that a body namely Finance Commission must be established by the President of India to determine what would be the financial relation between central and state government. So first Finance Commission was established in 1951.Now to regulate that commission one act was passed called as Finance Commisssion (Miscellaneous Provision)Act,1951 which clearly describes qualification required, disqualification, powers of Finance Commission. If one look into its composition there is one chairman and five other member. Also this commisssion is appointed every 5 years. But the main rationale behind constituting Finance Commission under Constitution of India is vast regional diversity that existed in India and that's why there was need of some authority which provides recommendation relating to measures and methods of revenue distribution between state and centre.

HISTORY:-

At the time of framing of constitution, the huge expenditure which will be needed by the states had been recognized by the framers. The drafting Committee rejected the recommendation given by the then Expert Committee on Financial Provision but accepted the creation of the Finance Commission. Then provision for Grants-in-aid was created under Article 275 and Finance Commission under Article 280.Also Article 282 also remained in controversy because this article provides that State or Union may make grant for any public purposes which was objected by various scholars because they hold the view that this particular provision was created for meeting contingencies like expenses that can be arises for refugee relief.

COMPOSITION OF FINANCE COMMISSION:-

The composition of Finance Commission is provided by Article 280 of the Constitution of India. According to it, there must be a Chairman and four other members who must be appointed by the President of India and they are eligible for re appointment. Also Parliament is authorised to make provisions related to qualifications, conditions of service of members and also the powers of the Finance Commission.

So qualification required to be a chairman of Finance Commission that he must have vast experience in Public affairs and other four members shall be selected among persons who

a)have qualification as par with a judge of High Court

b)must possess knowledge of Accounts and Finance of government,

c)have vast experience in matters of Finance and

d)have knowledge of economics

A member or chairman is become disqualified if he

a) is of unsound mind,
b) is an undischarged solvent(bankrupt),
c) is convicted of an offence and
d) has such financial or other interest which is likely to affect prejudicially his functions as a member of the commission.

FUNCTION OF FINANCE COMMISSION:-

As a quasi judicial body, the primary functions of Finance Commission to make recommendations to President on following matters[1]:-

1.On the basis of their respective contribution in tax, the distribution of funds between the Centre and States.

2.Principles are formulated which govern Grants-in-Aid to the States by Central Government.

3.For augmentation of Consolidated fund of a state ,it will recommend measures in order to supplement the resources of the Panchayats and Municipalities in the States based on the recommendations of the State Finance Commission.

4.It involves any matter referred by the President to the Commission.

FOURTEENTH FINANCE COMMISSION:-

On 2 January,2013,the Fourteenth Finance Commission was constituted by the President of India to make recommendations for the period 2015-2020.The chairman appointed for the commission was Dr. Y.V. Reddy. Also Ms. Sushama Nath, Dr. Sudipto Mundle were appointed full time members. Prof. Abhijit Sen was appointed as a part time member. Shri Ajay Narayan Jha was appointed as Secretary to the Commission.

RECOMMENDATIONS MADE BY THE 14TH FINANCE COMMISSION OF INDIA:

The major recommendations given by Dr.Y.V.Reddy in 14th Finance Commission are given below:-

1.DEVOLUTION OF TAX

VERTICAL DEVOLUTION:-

The 14th Finance Commission recommend that share of states in the net proceeds of sharable Central taxes should be 42% against 32% which was 10% higher than the recommendation of 13th Finance Commssion.

HORIZONTAL DEVOLUTION:-

The criteria for horizontal sharing, i.e. the distribution of the taxes between States was changed by 14th Finance Commission. The most significant changes are the 10% weight assigned to the 2011 population, and the

[1]Article 280,The Constitution of India

7.5% weight assigned to forest cover. (Table 1 below)[2]

TABLE 1A : 14TH FC HORIZONTAL SHARING CRITERIA	
CRITERIA	WEIGHTAGE
1971 population	17.5%
2011 population	10%
Income distance	50%
Area	15%
Forest cover	7.5%

GRANTS-IN-AID:-

It is recommended that must be discontinuance of State and sector specific grants-in-aid and Grants-in-aid are only awarded for removing deficits, for local governments and disaster management and for this the sum has been increased from Rs.3.19 lakh crore to Rs.5.37 lakh crore.

LOCAL GOVERNMENT:-

Under the relevant legislations, there is requirement of local bodies to spend the grants on the basic services for the functions assigned to them.

Also it was recommended that there should be division of grants into two parts- a basic grant and other one is performance grant for gram panchayats and municipalities. Performance grants are being provided to address the following issues:

(i) reliable data on local bodies' receipt and expenditure must be available through audited accounts; and

(ii) There must be improvement in own revenues.

For Gram Panchayats,10% will be the performance grant90% of grant will be the basic grant .In case of Municipalities the ratio of division between basic and performance grant will be 80:20.[3]

POPULATION AND DEMOGRAPHIC CHANGE:-

A weight of 17.5% to the 1971 population and a 10% weight to the 2011 population was recommended by the 14th Finance Commission. These 1971 and 2011 population figures, if we look into, considered as factor in demographic changes since 1971.

FISCAL CAPACITY(AS INCOME DISTANCE):-

A measure to determine the economic backwardness of a state is called Fiscal capacity. Its main purpose to find out how backward a state is as more backward the state, the more fund allocation of fund for it.

[2]https://www.indiabudgetgov.in

[3] https://www.doe.gov.in

The 14th FC has calculated the income distance following the method adopted by the 12th FC. A three-year average (2010-11 to 2012-13) per capita comparable Gross State Domestic Product (GSDP) has been taken for all the twenty-nine States, Goa has the highest per capita GSDP, followed by Sikkim. Haryana, the next highest GSDP State, has been considered as the reference State to arrive at the Income Distance of all the States.

FISCAL DISCIPLINE:-

Fiscal Discipline is a measure of the State's handling of its finances was one of the components in horizontal distribution formula till 12th Finance Commission., although the 14th Finance Commission has done away with it as a horizontal distribution component saying it as an inaccurate method.

DISASTER RELIEF:-

During 2015-2020,the Government of Odisha will receive Rs.4130 crore out of which the state's share will be Rs.413 crore and centre's share is Rs.3717 crore.If we look into fund devolution to State Disaster Response Funds of the states, Odisha can be ranked as 4th in the number. Maharashtra will get the highest i.e Rs.8195 crore followed by Rajasthan and Madhya Pradesh.

TAX EFFORT:-

The measurement of State's ability and initiatives undertaken by it in order to improve its tax base is called tax effort. This practice was also discontinued by the 13th Finance Commission as well as by 14th Finance Commission which was a double blow for states generating higher tax revenues as well as to states which manages its finances with prudence.

LAND AREA & FOREST COVER:-

One of the parameters in the horizontal devolution split since the 12th Finance Commission is the 'Land Area' which was based on the concept that the greater the land area of a state ,higher will be its public expenditure and administrative expenses. According to 14th Finance Commission recommendation, this concept is retained and its weightage increased from 10% to 15% although it is debatable. Forest Cover is also included as a parameter for measuring horizontal devolution.

GST(GOODS AND SERVICES TAX):-

GST is the combination of all the state and central taxes. The min taxes include is Union's Excise & Service Tax, and States's VAT & CST. This will get into the Centre's divisible pool and thus would reach the states as per the horizontal devolution formula and at same time lose control over its largest revenue pools VAT and CST which will then be subsumed under SGST.

Variable Weights Accorded (13th FC) (14th FC)		
Population(1971)	25.0	17.5
Population(2011)	0.0	10.0
Fiscal capacity/ Income distance	47.5	50.0
Area	10.0	15.0
Forest Cover	0.0	7.5
Fiscal Discipline	17.5	0.0
Total	100	100

Source: Economic Survey 2014-15

COMPARISON WITH 13TH FINANCE COMMISSION:-

1.The recommendation of 14th Finance Commission increase the share of the states in the divisible pool from 32% (by 13th FC) to 42% which is the biggest ever increase in vertical tax devolution.

2.Unlike 13th Finance,the 14th Finance Commission has not made any recommendation concerning sector specific grants.

HORIZONTAL DEVOLUTION FORMULA IN 13TH AND 14TH FINANCE COMMISSIONS

RECOMMENDATION WHICH PROMOTES FEDERALISM:-

1.The State and Centre are now seen as a equal partners in development.

2.The recommendation of 14th Finance Commission make a record increase in the devolution of divisible pool of resources to States which as a result leaves far less money with the Central Government.

3.This 10% devolution of the divisible pool can also provide freedom to the states to change their course of their development.

4.Not only development but higher tax devolution will allow great autonomy for finance and design and without it local development needs cannot be met and a marginalised communities and backward regions cannot be brought into the mainstream of life.

5.With the objective of lowering down the compliance cost and distortions to the economy, GST is designed which is a very good tax system with broad base ,low rate and minimal rate differentiation.

6.Allocation of autonomous and independent GST compensation fund can be beneficial to the states.

7.The replacement of the Planning Commission with NITI Aayog to ensure a common forum for forging a national vision on development and at the same time help in developing a strategy and its execution also involves states in discussing and planning priorities which promotes federalism.

RECOMMENDATIONS WHICH DEMOTE FEDERALISM:-

1.Some States have given access to the resources while other states have to come up with their own share of funds which clearly shows that certain states had provided with priority over the others.

2.It is true that if larger amount of devolution is provided then there will be more clarity of flow but at the same time there is no sanction if there is default of funds to local bodies.

3.One of the problem is that the states have to make up with the type of grants that are provided to them.

4.The 14th Finance Commission recommendation wound up the Backward Regions Grants Fund(BRGF).The result is that Bihar which got weightage for funding through this criterion will be the one which will be most badly affected.Also being the least developed state,it is more likely to affect its Gross Domestic Product adversely.

5.Transforming Planning Commission into NITI Aaog has led to loss of plan grants to states which are well performing.One of the best example is Karnataka which lose plan grants.As a result extra funds have to be mobilized by the Government of India and for this reason states can ask for higher untied grants.

6.The 42% unconditional grants will provide a free hand to states to operate the finances and inequities with freedom to states are what could be expected.

7.Moreover if we carefully observe there is sacrifice of equity principle in process of providing the unconditional grants of 42% to the states which may result into federal chaos instead of cooperative federalism unless strong and additional arrangement is made to guard the objective of present government.

CONCLUSION:-

After observing the merits as well as demerits of the recommendations we can say that Finance Commission helped in strengthening the Centre-State fiscal relationship which is a critical element must be present in federal country like India.

This relationship can be strengthened by providing the scheme for tax sharing in the divisible pool and as well through fiscal grants to the needy states.So the Finance Commission has pivotal role in a federal system because it increases economic position or status of the weaker states on par with richer states. It has also played a momentous role in eradicating regional disparities in India by making due weightage to backwardness of a State an important criterion. But there are certain difficulties in their exercise such as they are very much sensitive to the issues like underlying GDP growth, revenue and expenditure estimations., CAS amounts etc. assumptions. Also there are estimates which have only been presented for year 2015-16.But even after such complications the additional factors such as GST implementation and next Pay Commission will affect projections in upcoming year and along with the tax devolution will move the country towards greater fiscal federalism by conferring financial autonomy to states. With the creation of NITI Aayog, it will ultimately help in the achieving cooperative and competitive federalism vision of Government.

However if we look into recommendations we can observe that there are some discomfort that has arisen in some quarters like the horizontal distribution of resources allocated can lead to the classification of gainers and losers among the states. Also the recommendation added forest cover as a criteria for devolution of tax, states can lose their share in devolution.[4]

To sum it all, we can say that this new arrangement can brought a big change in governance because it provides a big responsibility in the hands of government due to which it cannot be remain as only a spectator and waiting for centre to give its direction rather it can take its own decision and initiate policies and help in bringing the development of states into the new direction. But at the same time, to act more independently in implementing the economic policies, it is going to be more tough and challenging task for the state government. If we look into the view of other analysts, they are more cynical about the smaller states that whether the tax devolve would result in the growth which must be progressive. But it is expected that they will prove their capability by achieving this target by taking adequate measure.

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[4] www.conference.com/FinanceCommission