



Strengthening the federal link

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Highlights

- The State Finance Commission (SFC) is a unique institution created by the 73rd and 74th Constitutional Amendments (CAs) to rationalise and systematise State/sub-State-level fiscal relations in India.
- It has few parallels in other federal systems whose primary task is to rectify growing horizontal imbalances in the delivery of essential public services to citizens.
- But there has been inadequate appreciation of the significance of this institution by the Union, States as well as the professional community.
- Article 243I of the Constitution mandated the State Governor to constitute a Finance Commission within one year of the CAs (before April 24, 1994) and thereafter every five years.
- Till date, only Assam, Himachal Pradesh, Tamil Nadu and Kerala have submitted their fifth SFC reports where many States are yet to cross the third SFC stage. The large majority has violated the mandate of the Constitution with impunity.
- The UFC has been widely acknowledged as a professional and quasi-judicial body when compared to the SFC.
- In order to properly compare UFCs and SFCs, certain facts have to be put in perspective.
- For historical reasons, UFCs have chosen a restrictive role of staying away from plan and investment allocations. SFCs normally could not do this although some have chosen the UFC path.
- Now that the Planning Commission has been dismantled, the 15th UFC has to spell out its decision-making domain.
- It is important to disabuse the notion among several politicians, policy makers and even experts that SFCs and the local governments they deal with have an inferior constitutional status when compared to the UFC.
- The SFC is undoubtedly modelled on the UFC created under Article 280 and exemplified in Articles 243I and 243Y.
- While the UFC is tasked with rectifying vertical and horizontal imbalances at the Union-State level, the SFC has to perform the same with reference to State/sub-State-level institutions.
- The Constitution treats a local government on a par with a State government, especially when it comes to sharing of financial resources.

Issues with SFC

- What is not adequately appreciated is that the task of the SFC to correct horizontal imbalances is extremely onerous when compared with the UFC as SFCs have to consider nearly 2.5 lakh local governments to promote minimum essential services in rural and urban areas.

- By implication, an SFC is the institutional agency to implement the golden rule of cooperative federalism that every citizen should be assured minimum public goods irrespective of her choice of residence.
- Article 280(3) has been amended to add clauses (bb) and (c) in order to take measures to augment the resources of panchayats and municipalities on the basis of the recommendations “made by the finance commission of the state”.
 - These sub-clauses affirm the organic link between local governments and SFCs to fiscal federalism.
 - It is only when inter-State disparities are reduced by the UFCs through their inter-se distribution criteria and intra-State disparities are reduced by SFCs through the horizontal distribution criteria, that the Indian federation becomes a sustainable and inclusive nation-state.
- UFCs had no data problem in reviewing the finances of the Union and States as the financial reporting system of the Union and States is well laid down.
 - On the other hand, local governments with no proper budgetary system are in deep disarray and, because of that, SFCs face a crucial problem of reliable data.
- The seriousness, regularity, acceptance of recommendations and their implementation which characterize the Union Finance Commissions (UFCs) are conspicuously absent when it comes to SFCs.
- A cursory survey of the composition of SFCs would reveal the overwhelming presence of serving and/or retired bureaucrats rather than academics for which the States have to bear their share of the blame for this.

Way Forward and Conclusion

- The federalist development state of India can grow only through a process of evolutionary policy making which works towards cherished goals.
- Moreover, UFCs have failed to play a hand-holding role in placing decentralized governance properly in the cooperative federal map of India.
- Without presenting a consolidated account of the reality at the sub-State level or highlighting which report went wrong, where and how, no UFC can legitimately guide States or contribute to improving the goals of constitutional amendments.
- All the terms of reference of UFCs (since the 11th) iterate the need for suggesting measures to augment the resources of panchayats and municipalities as a core task.

In sum, SFCs have not been provided with the necessary environment to play their rightful role in Indian fiscal federalism. A great opportunity to build regional equity in India has been undermined.

