Changes and challenges of FC

What is the issue?

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- Union government will soon constitute the 15th Finance Commission (FC).
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- It is significant to take a look at the changes and challenges faced by earlier commissions.
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What is the brief role of finance commission?

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- Article 280 of the Constitution requires that a Finance Commission be constituted to recommend the distribution of the net proceeds of taxes between the Centre and states, and among the states.
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- The framers of the Constitution were seeking to address the vertical imbalance between the taxation powers and expenditure and responsibilities of the federal government and the states.
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- And the horizontal imbalance, or inequality, between states that were at different stages of development.
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- Ensuring inclusiveness is, therefore, a key mandate of the Finance Commission.
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- That means assigning weights to things like population, the fiscal distance between the top ranked states and the others, etc.
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- It is not that the best-performing state will be allocated the highest share - even if delivery execution and governance are better - rather, the effort will be to narrow the development gap between states.
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- The Commission’s biggest role has been to uphold the country's federal

structure, and to be an architect of fiscal restructuring from being mainly an arbitrator between the Centre and states.
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What are major changes and challenges of FC over the years?

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- **Members of the commission -**The Finance Commission Rules, 1951, lay down the criteria for being members of the constitutional body:
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1. Those having special knowledge of finance and accounts of government with wide knowledge.
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2. experience in financial matters and in administration, or with special knowledge of economics, and
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3. Those who have been qualified to be appointed as a judge of a High Court.
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- In the years following the reforms of the 1990s, Commissions have been headed by reputed economists and administrators.
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- In 2015, the Planning Commission in its old structure and form has been dismantled, and has been replaced with the Niti Aayog.
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- 12^{th} FC had suggested to the government that it could alternate between an economist and a political figure such as a former state Finance Minister to be the Chairman.
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- **Transfer of resources -** Between the Centre and the states, is the scale of distribution of tax proceeds has been changed from 10% of the total tax receipts of the Centre in 1950, to a record 42% after the recommendations of 14^{th} FC
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- It is a share that makes previous awards look conservative, and sits well with the spirit of cooperative federalism.
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- **Lending equation -** 12th FC, rather than the Centre borrowing and then lending to states, it recommended that states be allowed to borrow directly.
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- Since then, the debt obligation of states to the Centre has come down significantly, the problem is with the repaying capability of the states.
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- Grants that were recommended by the Commission are however conditional which may also have been criticised.
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What are the challenges before the 15th FC?

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- Approach of the government on the composition of the Fifteenth Finance Commission, whether it will follow the convention of having a member of the (erstwhile) Planning Commission as a part-time member or a different approach is dubious.
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- Taking into account of the collections by each state after the roll out of the GST,the criteria for distribution of resources needs to be reviewed.
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- The challenge now is due to the share of net tax proceeds between the central government and states is almost equal.
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- Rising the bar on higher transfer(42%) of resources will have a much bigger impact on the federal government.
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- Constitutional amendment is needed to fix a ceiling on the distribution of the net tax proceeds among states.
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Source: Indian Express

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