State Finance Commission

For Prelims: **State Finance Commissions**, **Constitutional Bodies**, **Article 243-I**, **73rd Constitutional Amendment Act, 1992**, **Panchayati Raj Institutions (PRIs)**, **Urban Local Bodies (ULBs)**, **15th Finance Commission (2021-26)**, **Finance Commission**, **Municipal Councillors**, **Article 280**, **Consolidated Fund of India**, **Consolidated Fund of a State**, **16th Finance Commission**.

For Mains: Role of State Finance Commissions in financial decentralisation.

Source: IE

Why in News?

According to the **Ministry of Panchayati Raj, all states**, except Arunachal Pradesh have constituted **State Finance Commissions (SFCs).**

- The **15th Finance Commission,** in **its report**, expressed significant concern over delays in constituting SFCs.

What are the Key Points about State Finance Commissions (SFCs)?

- **About:** SFCs are **constitutional bodies** established by states under **Article 243-I** of the Indian Constitution.
  - As per **Article 243-I,** the **Governor** is required to constitute an SFC within one year from the enactment of the **73rd Constitutional Amendment Act, 1992** and **every five years thereafter.**
- **Mandate**: Their primary role is to recommend the **distribution** of financial resources between the **state government and its local bodies** i.e., **Panchayati Raj Institutions (PRIs) and urban local bodies (ULBs).**
- **Compliance Issues**: The **15th Finance Commission (2021-26)** highlighted that **only nine states** have constituted their **6th SFC**, even though it was due in **2019-20** for all states.
  - **Many states** remain stuck at the **2nd or 3rd SFC,** indicating a lack of timely renewal and updates.
- **15th Finance Commission on SFCs**: The 15th Finance Commission recommended states establish SFCs, implement their recommendations, and submit an **action report** to the legislature**.**
  - It suggested **withholding grants for states** that do not comply with these requirements.
- **Role of Ministry of Panchayati Raj**: It is tasked with **certifying compliance by states** with constitutional provisions for SFCs before the release of grants for **2024-25 and 2025-26.**

Why Appointment of State Finance Commissions (SFCs) is Important?

- **Constitutional Requirement:** Regular and timely constitution of SFCs every five years under Article 243(I) is a **constitutional mandate** aimed at ensuring **financial health and autonomy** of local bodies.

- **Fiscal Devolution**: The distribution of state revenues among **local tiers** ensures a **fair allocation of funds,** balancing the financial strength of local bodies.
    - This role complements the Union **Finance Commission's** allocation of central funds to states and local bodies.
- **Enhancing Accountability:** By **evaluating** financial needs, suggesting **optimal utilisation** of resources, and recommending **fiscal measures**, SFCs can drive local governments to improve **service delivery** and **become more responsive** to citizens' needs.
    - SFCs provide mechanisms for **performance-based evaluation**, which could lead to a system of **rewards and penalties**, fostering better governance practices at the local level.
- **Addressing Local Needs Directly**: Local governance bodies **impact daily life** by providing services like **sanitation, health, education, and infrastructure**.
    - Proper funding and financial autonomy, supported by SFC recommendations, are key to improving service quality.
- **Bridging the Functional and Financial Gap**: Local bodies often face **unfunded mandates** due to a lack of financial resources.
    - SFCs address this by recommending **financial devolution** based on responsibilities, ensuring local governments have the resources to **meet their obligations.**
    - SFCs can **streamline fiscal transfers**, improve funding predictability, and reduce volatility with effective recommendations.
- **Political and Administrative Decentralisation**: The role of SFCs extends **beyond fiscal recommendations**. It serves to empower **local elected representatives** like **municipal councillors** **and** **panchayat pradhans**.

Finance Commission

- **Constitutional Basis**: It is a constitutional body established under **Article 280** of the Indian Constitution.
    - It is appointed by the **President** every **five years** or at an earlier time deemed necessary by the President.
- **Composition**: The Commission consists of a **Chairman** and **four other members** appointed by the President.
    - The **chairman** should be a person having **experience in public affairs**.
- **Functions and Duties**: The primary function of the Finance Commission is to make **recommendations to the President** on various financial matters.
    - **Tax Distribution**: It recommends the distribution between the **Union and States** of the net proceeds of taxes that are to be divided between them.
    - **Grants-in-Aid**: It suggests the principles for grants-in-aid from the **Consolidated Fund of India** to the States.
    - **Augmentation of State Funds**: It recommends measures to **augment the** **Consolidated Fund of a State** to supplement the resources of **Panchayats** and **Municipalities** based on the recommendations of the State's Finance Commission.
    - **Additional Matters**: The Finance Commission may also address any other matter referred to it by the President in the interest of sound public finance.
- **Significance for Local Governance**: The Finance Commission not only determines the financial relationship between the **Union and States** but also recommends ways to strengthen **local bodies' fiscal capacities.**
    - This ensures that local governments have **sufficient funds** to provide essential services, contributing to **decentralised governance** and **people-centric policies**.
- **16th Finance Commission:** The **16th Finance Commission** was constituted in **December 2023** with **Arvind Panagariya** as its Chairman.
    - It covers an award period of **5 years commencing 1st April, 2026.**

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Finance Commission

The Finance Commission is the balancing wheel of fiscal federalism in India

~ Indian Constitution

Article 280
(Indian Constitution Part XII)

Constitution of FC as a **Quasi Judicial Body**

Constituted by

President of India **quinquennially** (or earlier)

Members

- Chairman + 4 members **(including an HC judge)** – appointed by President
- Authority to **decide qualifications – Parliament**
- Tenure – as **specified by the President**
- **Reappointment – Eligible**

Makes Recommendations to President about

- Distribution of **net tax proceeds** between Centre and States
- Principles for **grants-in-aid** to the states by the Centre
- Evaluates the rise in the **Consolidated Fund of a state** to affix the resources of Panchayats/Municipalities
- Other **financial matters referred** to it by President

Recommendations of the FC are **only advisory and not binding on the Government*

Powers of a Civil Court

As per Code of Civil Procedure 1908

First FC
(1952–57)
Chairman - KC Neogy

Second FC
(1957–62)
Chairman - K Santhanam

Current/Fifteenth FC
(2021–2026)
Chairman - NK Singh

State Finance Commission

- Constituted by **Governor** every 5^{th} year **(Article 243)**
- Reviews the financial position of **Panchayats and Municipalities**

Drishti IAS

What are the Problems with State Finance Commissions (SFCs)?

- **Lack of Political Will**: There is **widespread resistance** among state governments to **fully devolve power** and resources to local bodies, as intended by the **73rd and 74th constitutional amendments.**
- **Resource Deficiencies**: SFCs often need to **start from scratch** when collecting data due to a **lack of readily available and organised information,** further hampering their effectiveness.
- **Deficiencies in Expertise**: Many SFCs are led by **bureaucrats or politicians**, lacking domain experts and public finance professionals.
  - The absence of **qualified technocrats** diminishes the **credibility and quality of SFC** recommendations, which weakens their impact.
- **Opaqueness:** States often fail to table **Action Taken Reports (ATRs)** in the legislature after SFC recommendations, reducing transparency and accountability.
- **Ignorance of SFC Recommendations:** There is a pattern of **non-compliance with SFC recommendations** by state governments, which undermines the role of SFCs in shaping fiscal policies for local governance.
- **Peoples' Resistance:** Experts note that urban local bodies **face neglect, with low political awareness and limited public engagement**, which worsens the state of fiscal decentralisation.

Way Forward

- **Compliance with Constitutional Deadline:** States **must form SFCs every five years** as required by the constitution. Those missing deadlines should be held **accountable**, with **regular monitoring** to ensure compliance.
- **Reducing Political Resistance**: **State governments** should be aware of the benefits of **financial autonomy** for local governments, leading to **better services, citizen satisfaction**, and accountable governance.
- **Public Finance Experts**: States should ensure commissions are led by **economists, finance experts, and relevant professionals**, not just bureaucrats and politicians to enhance their efficiency.
- **Strengthening Local Data Systems**: Local bodies should adopt **modern data systems** for accurate financial reporting, aiding SFCs in making informed recommendations.
- **Action Taken Reports (ATRs)**: States must table **Action Taken Reports (ATRs)** in the legislature, outlining **timelines and measures** to implement SFC recommendations for better transparency and accountability.
  - Independent bodies can be tasked with **evaluating the effectiveness** of financial devolution and the implementation of SFC recommendations.
- **Incentive Framework**: The Ministry should create a **rewards system** for states that excel in SFC compliance, encouraging others to **improve local governance.**

Drishti Mains Question:

Discuss the role of State Finance Commissions (SFCs) in strengthening local governance in India.

UPSC Civil Services Examination, Previous Year Question (PYQ)

Prelims

Q. Consider the following: (2023)

1. Demographic performance
2. Forest and ecology
3. Governance reforms
4. Stable government
5. Tax and fiscal efforts

For the horizontal tax devolution, the Fifteenth Finance Commission used how many of the above as criteria other than population area and income distance?

(a) Only two

(b) Only three

(c) Only four

(d) All five

Ans: (b)

Q.The Constitution (Seventy-Third Amendment) Act, 1992, which aims at promoting the Panchayati Raj Institutions in the country provides for which of the following? (2011)

1. Constitution of District Planning Committees.
2. State Election Commissions to conduct all panchayat elections.
3. Establishment of State Finance Commissions.

Select the correct answer using the codes given below:

(a) 1 only

(b) 1 and 2 only

(c) 2 and 3 only

(d) 1, 2 and 3

Ans: (c)

Mains

Q. How have the recommendations of the 14th Finance Commission of India enabled the States to improve their fiscal position? (2021)

Q. How far do you think cooperation, competition and confrontation have shaped the nature of federation in India? Cite some recent examples to validate your answer. (2020)

1st Bodoland Mohotsov

Source: PIB

Recently, the **1st Bodoland Mohotsov** was organised on the **15th and 16th November** in **New Delhi.**

- **Theme:** Peace and Harmony for Prosperous Bharat.
- **Objective**: Focus areas include the **rich culture**, **language**, **education**, and **heritage** of the **Bodo community** and other communities from the **Bodoland Territorial Region (BTR)**.
- **Historical Significance**: It celebrated the recovery of the region post the **Bodo Peace Accord (2020)** which **resolved decades of conflict** and violence.

- **About Bodos:** Bodos are the **largest community** among **Assam's notified Scheduled Tribes**, making up about **5-6% of the state's population**.
  - In the **late 1980s,** the Bodos initiated a **mass movement** demanding a **separate state for the Bodos**.
- **About BTR:** Bodoland Territorial Region is an **autonomous region** in Assam consisting of four districts namely **Kokrajhar, Chirang, Baksa and Udalguri.**
  - It is administered by an **elected body** known as the **Bodoland Territorial Council.**

Read More: Bodoland Territorial Region (BTR)

CSR's Contributions to Agriculture Sustainability

For Prelims: Corporate Social Responsibility (CSR), **Small and Marginal Farmers**, **Fertilisers**, **Irrigation Systems**, **Cyclones**, **Livestock Farming**, **Precision Agriculture**, **Solar Power**, **Wind Energy, Biogas**, **Genetically Modified Organisms (GMOs)**, **Grain Banks, Water Conservation**, **Companies Act, 2013**, **NGOs**, **Companies (CSR Policy) Rules, 2014**, **Supply Chains**.

For Mains: Role of Corporate Social Responsibility (CSR) in development of agriculture.

Source: TH

Why in News?

With increasing contributions, the focus is on how **Corporate Social Responsibility (CSR)** can support **Indian agriculture** to become both **economically viable and ecologically sustainable.**

Why is CSR Needed in Agriculture?

- **High Dependence on Agriculture:** Nearly **47%** of India's **population** depends on agriculture for employment, compared to a **global average of 25%.**
- **Small and Marginal Farmers:** Over **70% of rural households** rely primarily on **agriculture** for their sustenance. Of this, **82%** of farmers are classified as **small and marginal.**
- **Poor Access to Finance: High Interest rates** and the **lack of formal credit** sources often prevent farmers from purchasing necessary **equipment, seeds** and **fertilisers**, limiting their growth and productivity.
- **Building Market Linkages:** Poor rural infrastructure, such as **inadequate storage facilities, transportation, and irrigation systems**, leads to post-harvest losses, inefficient supply chains, and reduced access to markets.
- **Environmental Challenges:** Unpredictable weather patterns lead to **crop failures, loss of livestock,** and increased vulnerability to natural disasters like **floods, droughts, and cyclones.**
- **Soil Degradation:** Improper **irrigation practices** and excessive use of **chemical fertilisers and pesticides** have led to soil degradation leading to reduced **soil fertility,** lower crop yields, and environmental damage.
- **Water Scarcity:** Water scarcity threatens both **crop production and livestock farming**, making irrigation and water management a critical issue.

How CSR Can Help in Agriculture?

- **Technological Innovations:** CSR initiatives can help **integrate advanced technologies** like sensors, drones, **GPS**, and data analytics into **Precision Agriculture**.

    - It will enable farmers to optimise **irrigation, fertilisation, pest control, and crop health** for more efficient and sustainable farming.
- **Financial Access:** Companies can collaborate with financial institutions to offer **low-interest loans and subsidies** to facilitate access to affordable financing and credit.
- **Renewable Energy:** CSR can encourage the use of renewable energy sources such as **solar power**, **wind energy**, **and biogas** in farming operations which can contribute to environmentally friendly and sustainable farming practices.
- **Biotechnology and GMOs:** CSR efforts can promote the development of biotechnology and **Genetically Modified Organisms (GMOs)**, making crops more resistant to pests, diseases, and stress, boosting yields, reducing pesticide use, and improving food security.
- **Empowering Farmers:** By providing access to knowledge, **skill-building programs, and hands-on experience** with modern farming practices, farmers can be better equipped to increase productivity, and reduce risks.
- **Improved Market Access:** CSR can help create market linkages by integrating farmers into **value chains**, ensuring they receive fair prices for their products, and enabling them to access larger and more lucrative markets.

Note

"Environment and sustainability" is the **second priority** for companies with **healthcare, water, sanitation, and hygiene** being the top priority.

- Examples of CSR-supported initiatives include **grain banks**, **farmer schools, water conservation**, **and energy-efficient irrigation.**

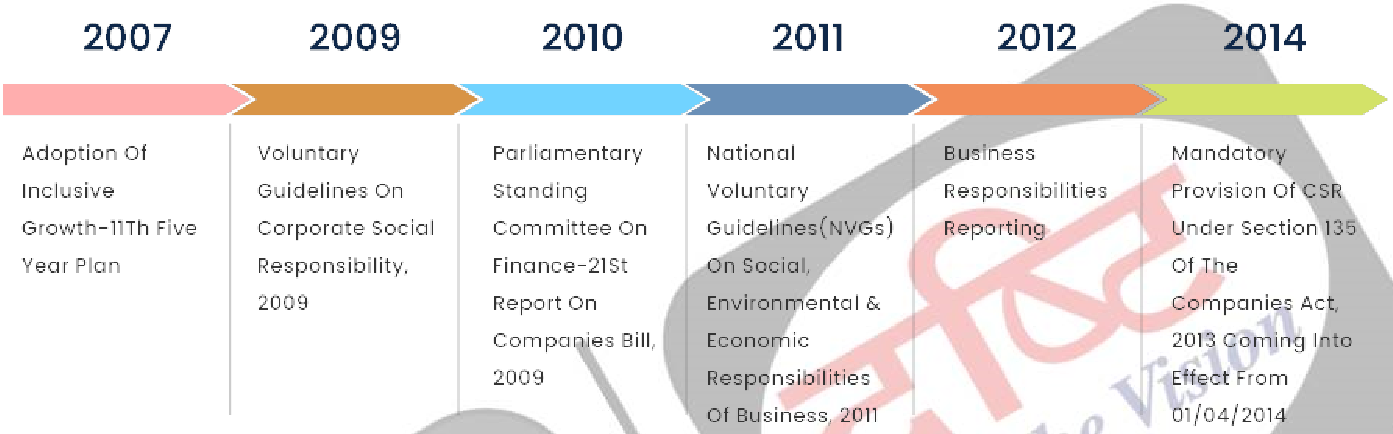
What are Challenges in CSR Implementation in Agriculture?

- **No Clear Demarcation:** CSR activities to Agriculture are **not clearly demarcated and well-defined.**
    - Under **Schedule VII** of the **Companies Act, 2013**, activities targeting agricultural sustainability could fall under **11 of the 29 development sectors** of CSR. E.g., gender equality, poverty, technology incubators, animal welfare etc.
- **Short-Term Focus:** CSR programs often focus on **short-term goals and deliverables**, while agriculture requires **long-term investments** and sustained support to yield significant outcomes.
- **Measurement of Social Impact:** The social impact of CSR in agriculture is often harder to measure, especially in rural areas.
    - **Evaluating improvements** in farmers' incomes, livelihoods, or well-being due to CSR projects can be **subjective and complex**.
- **Not-Aligned with Business Goals:** Many companies may find it **difficult to integrate CSR** in agriculture with their business strategies in a way that is mutually beneficial. E.g., **Cosmetic companies** have little incentive to invest in **farming practices**.
- **Ignorance of Agriculture: Education and health dominat**e CSR funding leaving **agricultural initiatives** with limited focus.
    - Also, a major **CSR fund** is diverted to other purposes like the **PM CARES Fund** which leads to a **dip in CSR expenditure** in specific sectors.
- **Fragmented Approach:** CSR initiatives often focus on **isolated aspects** of agriculture such as providing **training, technology,** missing broader challenges like **climate change**, **market access, and financing**.
- **Lack of Suitable NGOs:** Corporations often struggle to find **NGOs** in rural areas that align with their **CSR objectives**, leading to challenges in identifying the right partners for project implementation.
- **Disparity in CSR Spending:** A significant portion of **CSR funds (more than 30%)** is directed to more industrialized states like **Maharashtra, Karnataka, Gujarat, and Tamil Nadu**. This leaves less funding for less-developed regions.
- **Inefficient Allocation:** Many companies focus their CSR efforts in regions where they have **existing operations or deeper ties**, rather than strategically directing funds to areas with

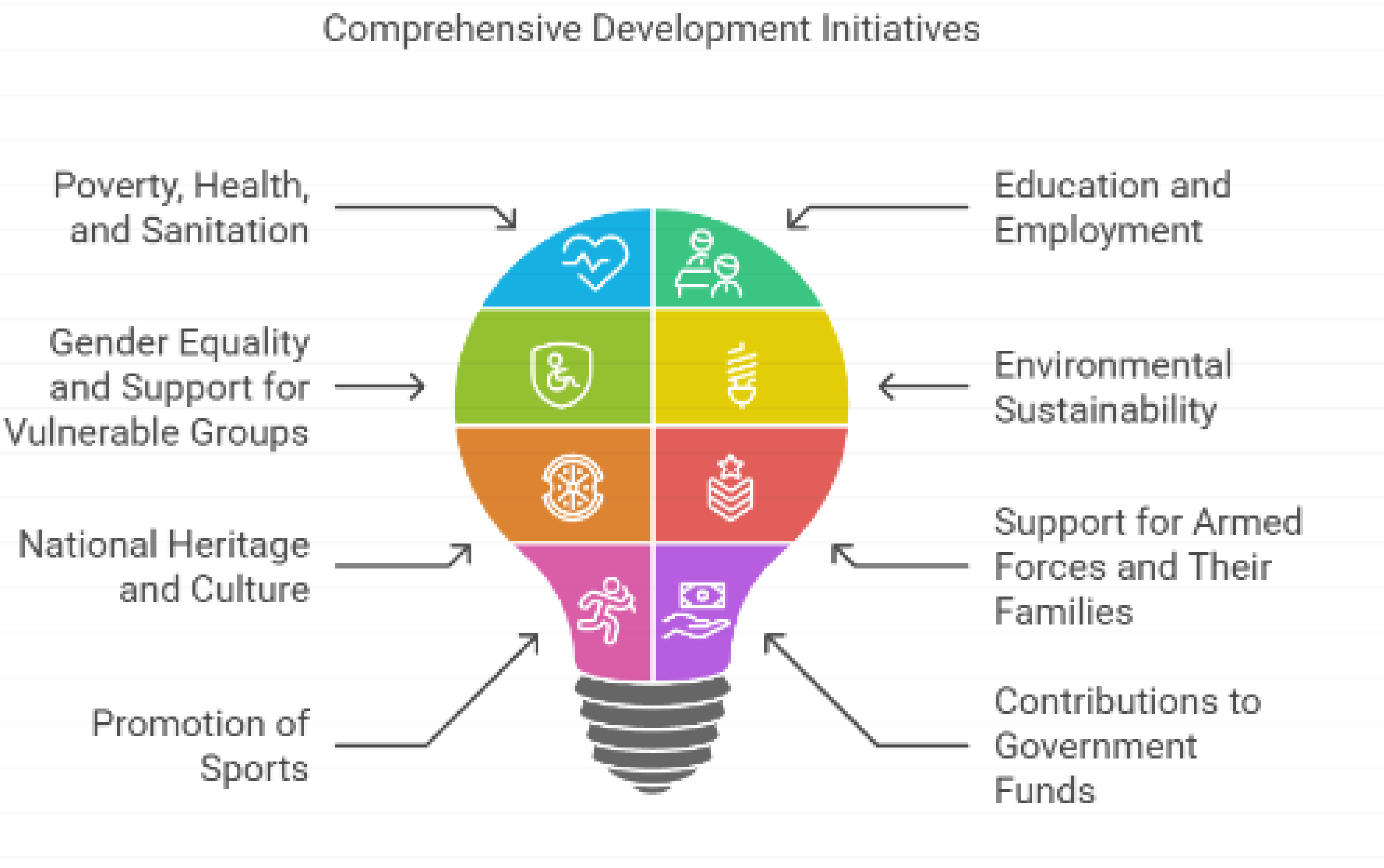
the most significant need.

What is CSR?

- **About:** CSR is a business practice in which companies **voluntarily integrate social, environmental, and ethical** concerns into their operations and interactions with stakeholders.
    - E.g., environmental sustainability, poverty reduction, education, and healthcare etc.
- **India's CSR Mandate**: India became the **first country to legally mandate** CSR in 2013 under **Section 135** of the Companies Act, 2013.
    - From 2014 to 2023, **Rs 1.84 lakh crore** of CSR funds were disbursed.
- **Legislative Framework:** The CSR concept in India is governed by **Section 135** of the **Companies Act, 2013, Schedule VII of the Companies Act, 2013 and [Companies (CSR Policy) Rules, 2014.]()**
    - CSR is a **mandatory requirement** for certain companies with effect from **1st April 2014.**



- **CSR Criteria:** CSR provisions apply to companies that meet any of the following criteria in the preceding financial year: a net worth of over Rs 5 billion, a turnover exceeding Rs 10 billion, or a net profit greater than Rs 50 million.
    - Such companies must spend a minimum o**f 2% of their net profit over the last three years** on CSR activities.
    - For **newly incorporated** companies with less than three years of operations, the average **net profit of available years** is considered.
- **National CSR Data Portal:** It is an initiative by the **Ministry of Corporate Affairs** to disseminate CSR-related data and information.
- **CSR Activities:** Companies can include the following activities in their CSR policies, as specified in **Schedule VII.**



Way Forward

- **Clearer Definition:** Establishing a **distinct sector** for **agricultural CSR initiatives** will help channel resources more effectively and ensure that funds are directly contributing to the sector's development.
- **Financial Inclusion:** By providing farmers with access to **affordable financial services,** CSR can empower them to invest in **quality inputs, adopt new technologies**, and increase their resilience to environmental challenges.
- **Supply Chain Stability:** Agriculture is a critical part of many industries' **supply chains, such as food, clothing, and pharmaceuticals**. By investing in sustainable agricultural practices through CSR, companies help ensure the long-term stability of their supply chains.
- **Competitive Advantage:** By solving agricultural challenges such as **water conservation, precision farming, and renewable energy use,** companies can develop new technologies or services that set them apart from competitors.
- **Alignment with Business Goals:** Companies can **align CSR programs with their core values**, such as **food companies** supporting **sustainable farming** and **tech companies** investing in **agricultural technology**, benefiting both their business and the sector.
- **Equitable Development:** Companies should **direct CSR efforts** to regions with **agricultural challenges,** even if they don't operate there, to promote **broader, more equitable development.**

Drishti Mains Question:

Discuss the role of CSR in promoting agricultural sustainability and the challenges faced in its implementation.

UPSC Civil Services Examination, Previous Year Question

Prelims

Q. Which of the following is issued by registered foreign portfolio investors to overseas investors who want to be part of the Indian stock market without registering themselves directly? (2019)

(a) Certificate of Deposit

(b) Commercial Paper

(c) Promissory Note

(d) Participatory Note

Ans: (d)

Mains

Q. With a consideration towards the strategy of inclusive growth, the new Companies Bill, 2013 has indirectly made CSR a mandatory obligation. Discuss the challenges expected in its implementation in right earnest. Also discuss other provisions in the Bill and their implications. (2013)

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