



## State Finance Commission

**For Prelims:** [State Finance Commissions](#), [Constitutional Bodies](#), [Article 243-I](#), [73<sup>rd</sup> Constitutional Amendment Act, 1992](#), [Panchayati Raj Institutions \(PRIs\)](#), [Urban Local Bodies \(ULBs\)](#), [15<sup>th</sup> Finance Commission \(2021-26\)](#), [Finance Commission](#), [Municipal Councillors](#), [Article 280](#), [Consolidated Fund of India](#), [Consolidated Fund of a State](#), [16<sup>th</sup> 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 **15<sup>th</sup> 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 [73<sup>rd</sup> 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 \(ULBs\)](#).
- **15<sup>th</sup> Finance Commission on SFCs:** The 15<sup>th</sup> 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**.
- **16<sup>th</sup> 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 1<sup>st</sup> April, 2026**.

# 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<sup>th</sup> year (Article 243)
- Reviews the financial position of Panchayats and Municipalities



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

- **Compliance Issues:** The [15<sup>th</sup> 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.**
- **Lack of Political Will:** There is **widespread resistance** among state governments to **fully devolve power** and resources to local bodies, as intended by the [73<sup>rd</sup> and 74<sup>th</sup> 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.
- **Opacity:** 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)