



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 \(ULBs\)](#).
- **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**.

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 5th year (Article 243)
- Reviews the financial position of Panchayats and Municipalities



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

- **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.**
- **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.
- **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)