Q14

How is the Finance Commission of India constituted? What do you know about the terms of reference of the recently constituted Finance Commission? Discuss. (15).

UPSC Civil Services Mains 2018 · GS II · 15 marks · Governance and Policy

Government policies and interventions for development in various sectors and issues arising out of their design and implementation.

Core demand of the question

- How is the Finance Commission of India constituted? What do you know about the terms of reference of the recently constituted Finance Commission? Discuss

Revision summary

Article 280 requires the President to constitute a Finance Commission every five years or earlier.

It has a Chairperson and four members with qualifications under the 1951 Act.

It recommends tax shares, grants-in-aid and resources for panchayats and municipalities.

The 15th Finance Commission (N.K. Singh, 2017) was asked to use Census 2011 and to design performance incentives.

GST impact, revenue-deficit grants and later a defence-security fund were the politically sharp ToR points.

Introduction

The Finance Commission is a constitutional body under Article 280. The President constitutes it at the end of every five years, or earlier if needed, to recommend how Union taxes are shared with the States and what grants-in-aid should go from the Consolidated Fund of India. The Commission recently in view in 2018 was the Fifteenth Finance Commission, constituted in November 2017 under N.K. Singh, with a terms-of-reference list that many States, especially in the south, read as a new political bargain.

Body

How it is constituted

- Article 280(1) says the President shall, within two years of the commencement of the Constitution and thereafter at the expiration of every fifth year or at such earlier time as he considers necessary, constitute a Finance Commission.
- The Commission consists of a Chairperson and four other members appointed by the President.
- The Finance Commission (Miscellaneous Provisions) Act, 1951, and the rules under it, set qualifications: the Chairperson should have experience of public affairs; members should be, or have been, or be qualified to be, a High Court judge, or have special knowledge of government finance and accounts, or of financial and economic matters, or of administration and financial

expertise.

• A Secretary and a small secretariat serve the Commission. It is not a permanent standing board; each Commission is a fresh body for a reference period.

• **Article 280(3) is the core mandate:** distribution of the net proceeds of taxes between Union and States and among States; principles of grants-in-aid; measures to augment a State's Consolidated Fund to supplement panchayat and municipality resources on the basis of the State Finance Commission's recommendations; any other matter referred by the President in the interest of sound finance.

• Recommendations are laid in Parliament with an explanatory memorandum; they are not a court decree, but convention and the Finance Commission's constitutional status give them high political weight.

Terms of reference of the Fifteenth Finance Commission

• Constituted on 27 November 2017 to make recommendations for 2020-21 to 2024-25 (later extended in coverage by additional ToR and a report in two parts).

• **Chairperson:** N.K. Singh. Members included Shaktikanta Das, Anoop Singh, Ashok Lahiri and Ramesh Chand, with a Member-Secretary.

• **Population:** the ToR asked the Commission to use the 2011 Census, which broke the older habit of giving heavy weight to 1971 population. States that had lowered fertility argued that they would lose share; populous States argued that current need must count.

• **Performance incentives:** the ToR asked the Commission to propose measurable performance-based incentives on GST implementation, power-sector reforms, ease of doing business, sanitation, forest cover, population control, and receipts and expenditure reforms.

• **GST:** the Commission was to consider the impact of the GST architecture, including compensation to States, on Union and State finances.

• **Revenue deficit grants:** the ToR asked whether such grants should continue, which worried States that still need Article 275 support.

• **Defence and internal security:** an additional ToR in 2019 asked the Commission to examine a dedicated fund, which raised a Union-first claim on the divisible pool.

• Disaster management, fiscal consolidation, and review of the FRBM framework were also on the list, along with grants to local bodies.

Discussion

• **Constitution is simple:** President, five members, 1951 Act qualifications, Article 280(3) heads.

• The 15th FC ToR was not a neutral photocopy of earlier Commissions. Census 2011, population-control rewards, and questions over revenue-deficit grants changed the horizontal-devolution politics.

• A Finance Commission must still be independent of the Union ministry that drafts the ToR. If the ToR pre-judges awards, federal trust falls even when the legal form of Article 280 is perfect.

• Sound finance, which the Article itself names, includes both Union defence needs and State social-sector needs. The ToR debate was about that balance.

Flow diagram

President Article 280 -> Chairperson plus four members

Chairperson plus four members -> Tax devolution

Chairperson plus four members -> Grants in aid Art 275

Chairperson plus four members -> Local bodies via SFC

15th Chairperson plus four members ToR -> Census 2011 and incentives

15th FC ToR -> GST and deficit grants

Conclusion

The Finance Commission is constituted by the President as a five-member constitutional body under Article 280, with qualifications set by the 1951 Act, to recommend tax sharing, grants and local-body supplementation. The recently constituted Fifteenth Finance Commission's ToR - 2011 population, GST, performance incentives, and later a defence-and-security fund - made the award a test of cooperative federalism, not a routine arithmetic exercise.

Facts & figures

Finance Commission (Miscellaneous Provisions) Act, 1951

Sets qualifications and conditions of service of the Chairperson and members.

Fifteenth Finance Commission

Constituted 27 November 2017; Chairperson N.K. Singh; award period from 2020-21.

Census 2011 in the ToR

Replaced the older heavy use of 1971 population and triggered protests from lower-fertility States.

Article 275 grants

Grants-in-aid of the revenues of States; the 15th FC ToR asked whether revenue-deficit grants should continue.