

## CHAPTER - 1

# THE STATE FINANCE COMMISSION ITS CONSTITUTION AND ITS ROLE

### 1.1.0 The Background :

1.1.1 Though a network of *Local Bodies*, both *Rural and Urban*, had been functioning in India even in the pre-independence period, but they could not develop as units of Self-Government. After independence, a number of steps were taken in the light of Directive Principles of the Constitution and also on the recommendations of a number of committees and working groups, appointed from time to time, to foster and develop Local Bodies. Despite that they could not attain the status of decentralized and autonomous units of Self-Governance, as envisaged in the Constitution, because of inadequate delegation of powers, functions, functionaries and financial resources. Elections could not be held at regular intervals. A large number of Local Bodies remained under long super-session.

1.1.2 Whereas, our Constitution has made provision for the *creation of Finance Commission* under article 280, to recommend devolution of resources from the Center to the States through Tax-Sharing and Grants-in-Aid, no such Constitutional arrangement was made for a long time since independence for recommending transfer of resources from the State Government to Local Bodies. *Thus, Local Bodies were handicapped in their functioning and their development because of a number of inadequacies and limitations – Constitutional, institutional, functional and financial.*

1.1.3 To overcome these limitations and inadequacies, and to *give a Constitutional status to Local Bodies*, so as to enable them to function as units of Self-Government, the Government of India introduced *two amendments in the Constitution in 1992, the 73<sup>rd</sup> amendment relating to Panchayati Raj Institutions, and the 74<sup>th</sup> to Municipalities*. The enactment of these two amendments may be regarded as watershed in the history and development of Local Self-Government in India.

1.1.4 These two amendments made it incumbent on the State Governments to either amend their existing legislation relating to ***PRI*s and *ULB*s** or enact new legislation, giving them necessary powers, authority and finances for discharging their Constitutional obligations, contained in ***XI and XII schedules***, respectively. The two amendments added a new dimension to the ***Decentralization Process and Fiscal Federalism***, by making provision for the creation of an appropriate institutional framework by the State Governments. This framework includes the creation of **3 institutions** at the level of each State, **(1) the *State Election Commission (SEC)***, to ensure and hold free and fair elections to Local Bodies, at regular interval of 5 years, **(2) the *State Finance Commission (SFC)***, to be appointed after every 5 years, to recommend devolution of funds from the State Government to Local Bodies, and also suggest measures for augmenting their Own Resources, **(3) the *District Planning Committee (DPC)*** at the level of every district, charged with the responsibility of coordinating and integrating plans for Economic and Social Development, designed by Local Bodies for their respective jurisdictions. In almost all the States of India, these three institutions have been created and are performing their Constitutional role, though in varying degree of efficiency and effectiveness.

#### **1.2.0 Chhattisgarh State Finance Commission :**

1.2.1 In response to the Constitutional requirement, under ***Article-243 (I) and 243 (Y)***, the erstwhile state of Madhya Pradesh, of which Chhattisgarh was a part, constituted the ***First State Finance Commission*** in 1995, under the M.P. Rajya Vitta Ayog Adhiniyam. The Commission submitted its reports, ***one relating to PRI*s and the other to *ULB*s**, in June 1999, and its recommendations covered the period of 1996-2001. The ***Second State Finance Commission*** was appointed in ***Madhya Pradesh*** in June 1999 and its reports were submitted in December, 2003. Its recommendations covered the period of 2001-2006.

1.2.2 When the present ***State of Chhattisgarh was carved*** out of ***Madhya Pradesh*** on ***1<sup>st</sup> November 2000***, the undivided State of Madhya Pradesh was being covered by the recommendations of the First Finance Commission. Though the Second Commission was constituted but it did not submit its report by that time. The new State of

Chhattisgarh had no option but to continue giving *financial assistance to Local Bodies in terms of Fiscal Package, as per the recommendations of the First Finance Commission*, as accepted by the Government of Madhya Pradesh in its Action Taken Report. Despite the fact that the recommendations of the First Finance Commission were to be implemented during the period of 1996-2001, *the Chhattisgarh Government, decided to continue the implementation of Fiscal Package recommended by the First Commission of M.P. till the report of its Own State Finance Commission is available for implementation.*

1.2.3 The New State of Chhattisgarh took some time for the creation of its *Own First State Finance Commission (SFC)*, since the legislation under which the Commission was to be appointed, was enacted in 2003. In pursuance of the *Constitutional requirement and under section -3 of the Chhattisgarh Rajya Vitta Adhiniyam 2003, the State Government constituted the First SFC for the State under a modification dated 22<sup>nd</sup> August, 2003 (Appendix No. 1.1)*, consisting of the following:

- 1) *Shri T.S. Singh Deo, Chairman*
- 2) *Shri Paras Chopra, Member*
- 3) *Dr. Hanumant Yadav, Secretary*

(The State Government reconstituted the Commission on 14/7/2004 and appointed *Shri Virendra Pandey, as its Chairman* and no other Member was appointed) (Appendix No. 1.2)

*Dr. Hanumant Yadav* will continue to perform the duties of Advisor to the State Planning Board, as well as of *the Secretary to SFC*, vide order dated 27/8/2003, issued by the Planning and Finance Department of the State Government. *The recommendations of the SFC would cover the period of 5 years, 2005-2010*, which is co-terminus with the period of award of the *XII FC. The Commission was required to submit its report by 31<sup>st</sup> December, 2004*. Since it could not complete its work by this date, its term was extended to 31<sup>st</sup> December, 2005, *than 30<sup>th</sup> April, 2007 and then 31<sup>st</sup> May 2007 by the order of the State Government (Appendix No. 1.3 To 1.7)*. After completion of tenure of Dr. Hanumant Yadav as Secretary on December 2006, *Dr. Sulochana Hablani* took over the charge of *Secretary. Dr. Hanumant Yadav* has been appointed as *Consultant* of the *State Finance Commission*.

### **1.3.0 Terms Of Reference (TOR) Of The State Finance Commission :**

1.3.1 *The Notification of the State Government regarding the TOR of the State Finance Commission was issued on 27/9/2003*, separately from the notification dated 22/8/2003 which created the SFC. The TORs as per notification are given in **Appendix No. 1.8** of this chapter. These are the Constitutional obligations of the SFC and are given below.

- (i) The distribution between the *State and the Local Bodies*, of the net proceeds of taxes, duties, tolls and fees leviable by the state, which may be divided between them, and the allocation between *Local Bodies at all levels* of their respective shares of such proceeds.
- (ii) The determination of Taxes, Duties, Tolls and Fees which may be assigned to or appropriated by *PRIs* and *ULBs*.
- (iii) The Grants-in-Aid to *Local Bodies* from the consolidated fund of the state.
- (iv) The measures needed to improve the financial position of the *Local Bodies*.
- (v) Make a review of the *State Finances* and also make projections of Revenue and Expenditure for the next five years on a *Normative Basis*.
- (vi) Estimation of *Revenue Gap* of Local Bodies, separately for *PRIs* and *ULBs*, by projecting their Revenue and Expenditure for the Next Five Years, on a Normative Basis.
- (vii) Recommendations of *XII<sup>th</sup> FC* for *PRIs* and *ULBs*.

1.3.2 A perusal of the TOR of the SFC shows that the commission has to cover the whole gamut of State and Local Finances in their different manifestations. In making its recommendations, the Commission shall have regard, among other considerations, to all items given at present in the notification.

#### **1.4.0 The Role Of The State Finance Commission :**

- 1.4.1 The creation of the *SFC* is not a mere Constitutional formality but an institution created with a definite role to play. The role of the SFC is mainly determined by its *Terms Of Reference and the Constitutional requirements. In terms of articles 243(I) and 243(Y) of the Constitution, the SFC is required to recommend the distribution between the State and Local Bodies of the net proceeds of Taxes leviable by the State and inter-se allocation between different Panchayats and Urban Bodies, assignment of certain Taxes and Grants-in-Aid. The Commission is also required to suggest measures needed to improve the Finances of Local Bodies in the State.*
- 1.4.2 The SFC has to play a crucial role in strengthening and augmenting the financial resources of Local Bodies, by addressing the problems of vertical and horizontal imbalances faced by them. It has to make a correct assessment of the needs of Local Bodies by estimating the *Revenue Gap* for the next five years (*2005-06 to 2009-10*), on some normative basis. It has also to suggest measures to fill up this gap through mobilization of *Own Resources* by Local Bodies and the *Fiscal Package recommended by the SFC*. The gap that may still remain may constitute the basis for the fiscal package to be recommended by the CFC to the States, for supplementing the resources of Local Bodies. The gap would thus facilitate the task of the CFC. At present, in the absence of such estimates to be made available by the SFC, the CFC have been recommending their devolution packages on adhoc basis. *The estimation of Revenue Gap of Local Bodies is a crucial task of the SFC.*
- 1.4.3 The *XI<sup>th</sup>* and the *XII<sup>th</sup>* *FCS* have bemoaned this fact that most of the SFCs are not playing their role adequately. Most of the States have yet to appreciate the importance of this institution in terms of its potential to carry forward the process of democratic decentralization further. It is a matter of great concern for the CFC that it could not adopt their reports as the basis of its recommendations.
- 1.4.4 The SFC has to play another important role and that is to make *assessment of State Finances and suggest measures for their restructuring* and also make *Projections of Revenue and Expenditure of the State* for the next five years. The fiscal health of the funding agency is crucial to the size of the devolution of resources to Local Bodies.

1.4.5 The SFC has to play another role and that is making recommendations in the area of *Capacity Building, Administrative Reforms, the relationship between the Elected Representatives and the Executive Wing of Local Government, Public-Private Participation in certain Local Civic Services, Privatization of certain functions of Local Bodies, Fiscal Reforms which may also include Accounting Techniques, Budgetary Procedures, etc. Building Up Data Base*-all these are clubbed together under the head “*Beyond The Fiscal Package.*”

1.4.6 The enlarged role of the *SFC* can alter significantly the nature and character of *Fiscal Federalism*. But the *problems facing Local Bodies are not only Financial but also Institutional, Structural, Administrative and Political, most of which have to be tackled by the State Government.*

**Appendix No. 1.1**

**Appendix No. 1.2**



**Appendix No. 1.3**

**Appendix No. 1.4**

**Appendix No. 1.5**

**Appendix No. 1.6**

**Appendix No. 1.7**

**Appendix No. 1.8**