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**Centre-State Financial  
Relations: Concerns and  
Challenges**

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## CENTRE-STATE FINANCIAL RELATIONS: CONCERNS AND CHALLENGES

### Context

- Public debt management is getting wider attention in Centre-State financial relations, against the backdrop of the recently constituted Sixteenth Union Finance Commission.

### About

- Kerala, had filed a suit in the Supreme Court of India against the Centre's decision on the net borrowing ceiling of States.
- These recent developments relate to a clarion call for "asymmetric fiscal rules" relating to deficits and debts in India.

### Centre-State financial relations.

- The Indian Constitution has all the **features of a federation with the specification of financial powers and functional responsibilities** of the Centre and the States .
- The **Union and the State Lists** under the **Seventh Schedule** prescribed in the Constitution under **Article 246** contain subjects in respect of which the Union and the States have exclusive jurisdiction to make laws, respectively.
  - In addition, a few subjects are listed in the Concurrent List in respect to which both the Union and the States have concurrent powers to make laws.
- Article 270** of the Constitution provides for the scheme of distribution of net tax proceeds collected by the Union government between the Centre and the States.
  - The taxes that are shared between the Centre and the States include corporation tax, personal income tax, Central GST, the Centre's share of the Integrated Goods and Services Tax (IGST) etc.

#### Do you know ?

- Article 280** mandates the setting up of a Finance Commission within two years from the commencement of the Constitution and thereafter at the expiration of every fifth year or at such earlier time as the President of India considers necessary.
- Each Finance Commission is required to make recommendations on:
  - sharing of central taxes with states,
  - distribution of central grants to states,
  - measures to improve the finances of states to supplement the resources of panchayats and municipalities, and
  - any other matter referred to it.

### Basis for allocation

- The share of States from the divisible pool (vertical devolution) stands at 41% as per the recommendation of the 15th FC.
- The distribution among the States (horizontal devolution) is based on various criteria.
- The criteria as per the 15th FC can be briefly explained as follows.
  - 'Income distance' : It** is the distance of a State's income from the State with highest per capita income.
    - States with lower per capita income would be given a higher share to maintain equity among States.
  - 'Population'** is the population as per the 2011 Census.
  - 'Forest and ecology'** consider the share of dense forest of each State in the aggregate dense forest of all the States.
  - 'The demographic performance'** criterion has been introduced to reward efforts made by States in controlling their population.
  - 'Tax effort'** as a criterion has been used to reward States with higher tax collection efficiency.

### Concerns of states government

- Over the years, the share of Union Finance Commission tax transfers has declined for a few States.
- The Union government has sought to keep an increasing share of its proceeds out of the divisible pool so that they need not be shared with States.
- It has also not been devolving the shares of net proceeds to the States as mandated by successive FCs.
- The Fifteenth Finance Commission has designed the tax transfer formula based on population (15%), area (15%), income distance (45%), demographic transition (12.5%), forest and ecology (10%) and tax effort (2.5%).
  - ♦ The weightage given to the distance of per capita income in the Finance Commission tax transfer formula adversely affects growing States, including Kerala.
    - This leads to the debate on equity versus efficiency principles of intergovernmental fiscal transfers.

### Suggestions and Way Ahead

- **Judicious bargaining with the Finance Commission** relating to magnitude and criteria (with weightage decisions) is key to ensuring the progressivity of fiscal transfers to the State.
- There needs to be a negotiation with the **Sixteenth Finance Commission** for specific-purpose transfers to tackle State-specific issues such as demographic transition, inward and outward migration and climate change crisis.
- **Fiscal transfer** based on the **advancement of gender budgeting** (including the care economy infrastructure) in the State is critical to redress gender inequalities.
- Apart from addressing rightful complaints on the inequalities in horizontal devolution, the stance of the 16th FC on vertical devolution would be critical to the survival of fiscal federalism in India.

### Mains Practice Question

**[Q]** Examine and review the Centre-State relations in the areas of finances and economic planning. Is India's fiscal federalism breaking apart? Give reasons to support your answers.

