The Scientific Temper (2024) Vol. 15 (4): 3387-3396 E-ISSN: 2231-6396, ISSN: 0976-8653
Doi: 10.58414/SCIENTIFICTEMPER.2024.15.4.49 https://scientifictemper.com/

RESEARCH ARTICLE

Financial devolution in a multilevel system: An evaluation of the working of state finance commissions in India

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Abstract

The significance of the efforts by local governments in achieving Sustainable Development Goals (SDGs) is paramount. However, local governments in India face several obstacles in achieving the SDGs, bottlenecks in the free flow of funds being one of them. The 73rd and 74th Constitutional Amendments, which constitutionalized rural and urban local governments in 1993, also mandated the periodic constitution of the State Finance Commission (SFC) as a constitutional body in India. The design of the SFCs aimed to replicate the Union Finance Commission (UFC) at the provincial level, promoting democratic decentralization from states to local bodies. These amendments introduced Articles 243I and 243Y, which mandated periodic institutions of SFCs to supervise the transfer of funds to local governments. By now, all states should have progressed to their seventh-generation SFCs. Several challenges, such as delay in the constitution of SFCs, non-synchronization of SFCs with UFC period, and delay in the submission of reports, have impeded the functioning of the SFCs as well as the UFCs. The 15th UFC has recommended using the SFC reports as a precondition for releasing grants to local bodies after March 2024. Even though the 16th UFC has already been constituted, only nine states have managed to submit the report of their 6th SFCs. Against this backdrop, this paper delves into the institution of SFCs in India, exploring their significance, analyzing the challenges they face, and proposing potential solutions.

Keywords: State finance commission, Union finance commission, Local government, Decentralisation, Multilevel federal system, Financial devolution.

Introduction

The importance of local action in securing shared prosperity in a sustainable world shall not be underestimated. The 17 Sustainable Development Goals (SDGs) agreed by the United Nations member states highlight the need for goal-oriented, specific responses at all levels. Although international organizations and governments at the national and state levels are vital in promoting SDGs, local government actions are essential for driving localized efforts that prioritize these goals. However, to ensure unhindered localized support for SDGs, the local governments need to be strengthened. SDG centric response from local governments faces barriers that impede local efforts aimed at achieving the SDGs. One such barrier that local governments in India face is the shortage of funds that results from the irregular appointment and operation of financial institutions among other factors.

The passage of the 73rd and the 74th Constitutional Amendments in 1992 marked a significant development in the framework of the Indian Constitution. These amendments brought about an important shift in the governance structure of the country. The 73rd and 74th Constitutional Amendments did two things: first, they constitutionalized institutions of rural and urban local governance and second, they legalized the decentralization of functions and devolution of finances to local bodies in India. Thus, India made a significant departure from a two-tiered federal system with governments at the center and the states to a multilevel federal structure with elected rural and urban local governments besides the center and the state governments. The structure of intergovernmental fiscal relations in India was also to undergo a significant transformation with the constitutional recognition of urban and rural local bodies. Towards that end, the constitution envisaged State Finance Commissions (*hereinafter* SFCs) to

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How to cite this article: Gupta, M., Khaire, D. (2024). Financial devolution in a multilevel system: An evaluation of the working of state finance commissions in India. The Scientific Temper, **15**(4):3387-3396.

Doi: 10.58414/SCIENTIFICTEMPER.2024.15.4.49

Source of support: Nil

Conflict of interest: None.

Received: 10/09/2024 **Accepted:** 10/11/2024 **Published** : 20/12/2024

rationalize and systematize the horizontal fiscal relations between the three tiers of government.

However, before we move on to understand the SFC, it is imperative to understand India's federal set up. The Union Powers Committee, a distinguished body within the Constituent Assembly, arrived at a common view on the adoption of centralized federalism in India (Second Report of the Union Powers Committee, 1947). Consequently, the Indian Constitution adopted a federal system with two tiers of government - a strong center as 'the union' and constituent provinces as 'the states'. Although local governments were intrinsic to the traditional system of governance in India and were strongly advocated for by Mahatma Gandhi, local governments did not form a separate tier of governance (Zamora, 1965; Rajasekhar, 2022; Sharma & Chakravarty, 2018). Rather, 'local government', as a subject under the Seventh Schedule read along with Article 246, formed part of the State List (List II) under Entry 5, thus falling under the exclusive legislative competence of the state governments.

The Seventh Schedule has three lists that specify the allocation of functions and funds between the union and the states. In comparison to the states, the central government has more authority to mobilize money under the Union List of the Seventh Schedule. However, the states bear a greater share of the expenditure in maintaining regional infrastructure, including roads, bridges, irrigation systems, public health and sanitation, agriculture, and local administrations. (Sharma et al., 2021). This mismatch in the distribution of powers and functions between the union, the states and the local governments has resulted in a vertical fiscal imbalance characterized by the union having a greater revenue-raising powers while the states bearing greater expenditure responsibility (Sharma et al., 2021). To account for the 'vertical imbalance' in distribution of the revenues of the union and the states, a comprehensive fiscal federal architecture was carved out in Part XII of the Constitution (Sharma et al., 2021). The institutional mechanism to facilitate the transfer of resources from the union to the states (and later to the local bodies) was also carved out under Article 280 of Part XII of the Constitution of India. Article 280 mandates the constitution of a Union Finance Commission (*hereinafter* UFC) to make recommendations to the President on the transfer of funds from the Union to states.

Following the constitutionalisation of the panchayats and municipalities, the states were, under Articles 243G and 243W, empowered to allocate roles and responsibilities to the local governments on matters listed in the Eleventh and the Twelfth Schedules. The states fulfilled their obligation by passing conformity legislation or amendments to the state laws. To enable the local governments to carry out these responsibilities, they were empowered to levy, collect, and appropriate certain taxes, duties, tolls, and fees, etc. Additionally, they were assigned a part of the state revenue and grant-in-aid from the consolidated fund of the state (Alok, 2021; Oommen, 2006).

Nevertheless, the functional responsibilities of the local governments far exceeded their financial powers. This gap made the local governments dependent on higher levels of government to finance their functions. Thus, arose the need for fiscal devolution to the rural and urban local bodies at the sub-state level (Chaudhuri, 2006). However, an arrangement similar to the UFC was missing at the sub-national level, where a similar body could recommend the transfer of financial resources from the states to rural and urban local bodies. As a result, under Articles 243I and 243Y, a provision for mandatory constitution of the SFC by every state was made to review the financial position of rural and urban local governments. In addition, clauses (bb) and (c) were inserted into Article 280 through these amendments. According to the amended Article 280, the UFC shall make recommendations to augment the Consolidated Fund of a state in order to support the financial needs of local governments. These recommendations shall be based on the suggestions of the SFCs. With this, the institutional vacuum of a body to review the financial position of local governments and recommend transfers of financial resources from the state to local bodies was plugged.

Over the years, the working of the SFCs has attracted severe criticism. The constitution of the 16th UFC has once again brought the working of the SFCs to the forefront. Successive UFCs have voiced their concerns on the sorry state of the SFCs. The 15th UFC has proposed that starting from March 2024, grants should only be given to states that have fulfilled the mandate of constituting SFCs. However, even after thirty-two years of the amendments, most states have failed to adhere to the constitutional mandate of constituting SFCs at regular intervals. The non-synchronisation of SFCs' award period with the UFC has been a challenge for fiscal devolution and thus, implementation of SDGs at the local level has also been hindered. Despite their relevance to strengthening local governments, the SFCs have been ignored by the state machinery, rendering them ineffective in most states. As a result, the progress of the local governments, as self-governing institutions have been badly hit. In this context, this paper concentrates on the constitutional institution of the SFC in India, scrutinizes its significance and the challenges it faces, and proposes potential solutions.

The constitutionalization of local government and the genesis of the State Finance Commissions in India

Local governments (primarily Panchayats and allied institutions) have existed in India since historical times (Zamora, 1965). However, the constitution did not include local governments in the formal structure of governance at its inception (Chaudhuri, 2006). As a result, local bodies were unable to achieve the status of decentralized and independent self-governing units, as envisaged in the constitution.

In the 1990s, India embarked on the route of democratic decentralization. The 73rd and 74th constitutional amendments institutionalized local bodies within the constitution as institutions of rural and urban self-government under Articles 243G and 243W. In addition to implementing various reforms such as conducting regular elections for local bodies and introducing reservations for women, the Amendments required the establishment of the following institutional framework for local governance:

- A State Election Commission, under Articles 243K and 243ZA, is responsible for overseeing and ensuring that elections to local bodies are conducted in a fair and unbiased manner every 5 years,
- Every five years, the state will establish an SFC under Articles 243I and 243Y to recommend the distribution of funds to local entities and investigate methods to improve the state's resources and
- A District Planning Committee, under Article 243ZD, is tasked with the duty of consolidating plans created by Panchayats and Municipalities within their respective areas and formulating a comprehensive development plan for the entire district.

The institutions under this framework were to be brought into existence by each state by their respective state legislations. Consequently, the states either amended their existing legislation(s) on local governments or enacted new ones to introduce the above-mentioned institutional framework and allow the rural and urban local bodies to discharge their constitutional obligations under the Eleventh and Twelfth Schedules, respectively.[1]

The provision for the constitution of the Finance Commission at the state level was a welcome idea. During the discussions on the draft Constitution, the members of the Constituent Assembly expressed their views on the fiscal federal structure of India. Interestingly, the Constituent Assembly did not address the importance of a finance commission at the provincial level to determine the allocation of funds between the states and the local governments. Although the Expert Committee on Financial Provisions 1947 recommended the establishment of a States Commission, the purpose for such recommendation was not financial decentralization but to develop the resources of the States to bring them in line with the provinces (Expert Committee on Financial Provisions, 1947). The Thungon Committee of 1988 was among the pioneers in suggesting the establishment of SFCs to oversee the distribution of resources to the local bodies (Biju, & Padmanabha, 2019). As a result, the Panchayati Raj Bill of 1989 (The Constitution (Sixty-fourth) Amendment Bill, 1989) included a provision for the Governor to regularly appoint a Finance Commission at the state level. Unfortunately, the Bill fell short of the necessary two-thirds votes in the Rajya Sabha, preventing it from becoming a law (Biju, & Padmanabha, 2019). Nevertheless, soon after the Parliament succeeded in passing the 73rd and 74th Constitutional Amendments in 1992.

1 The 11th and 12th Schedules offer a list of subjects (like public health, sanitation, agriculture, among others) in respect of which functions, finances and functionaries may be devolved by the State Government to local bodies.

Understanding the institution of SFCs

The SFC, just like the UFC, is a constitutional institution with technical and quasi-judicial functions. Its purpose is to assist local governments in devising strategies for economic growth and ensuring the provision of social justice and public services at the local level (Oommen, 2006). The SFCs were introduced as part of the provisions for local governments and were envisaged as institutions that would promote decentralization and local self-governance.

The constitution mandated the Governor of each state to constitute a SFC every five years, which dissolves upon the submission of its report. According to the Constitution, the first-generation SFCs were to be constituted within one year of the commencement of the constitutional amendments in 1993 and thereafter at the expiration of every five years. The SFCs are to make recommendations to the Governor on the following matters:

- The principles which should govern:
  - The distribution between the state governments and the local governments of the net proceeds of the taxes, duties, tolls and fees leviable by the state which may be divided between the local bodies at all levels and their respective shares of such proceeds [Articles 243I(1)(a) and 243Y(1)(a)];
  - The determination of the taxes, duties, tolls and fees which may be assigned to or appropriated by urban and rural local bodies [Articles 243I(1)(a) and 243Y(1)(a)];
  - The grants-in-aid to the urban and rural local bodies are provided from the consolidated fund of the state [Articles 243I(1)(a) and 243Y(1)(a)];
- The necessary actions to enhance the fiscal standing of local governments [Articles 243I(1)(b) and 243Y(1)(b)];
- Any additional subject brought before the SFC with the intention of guaranteeing financial stability to local governments [Articles 243I(1)(c) and 243Y(1)(c)].

Evidently, the SFCs are patterned in a manner that mimics the UFCs with the exception that the UFC aims to address the vertical and horizontal fiscal imbalances between the union and state levels, while the SFC focuses on fiscal imbalances at the state-sub-state level (Oommen, 2006). The SFCs play a crucial role in fiscal devolution by determining the principles for allocating taxes, fees, and other resources to local governments. They review local governments' finances to determine the principles that govern the distribution of revenue between the state and local bodies and suggest measures to improve local bodies' finances. The recommendations put forth by the SFCs form the basis on which the Finance Commission at the Union prepares its recommendation to boost the Consolidated Fund of a state to supplement local government resources.

According to Articles 243I(2) and 243Y, the composition of the SFCs, the necessary qualifications required for membership, and the process for selecting and appointing the members to the Commission are determined by their respective state legislatures. For instance, the State of Bihar enacted the Bihar Panchayati Raj Act, 2006 and the Bihar Municipal Act, 2007 to consolidate, amend, and replace the existing state laws on Panchayats and Municipalities.[2] These Acts also provide for the constitution and functioning of the SFC in Bihar, which reviews the financial position of Panchayats and Municipalities and makes recommendations for their improvement.[3] Similarly, other states also provide for the constitution and functioning of their respective SFCs, through their conformity Acts.

Further, under Articles 243I(4) and 243Y(4), every recommendations made by the SFCs must be presented to the state legislature accompanied by an explanatory memorandum outlining the actions taken in response to these recommendations. However, it is important to mention that the recommendations of the SFCs are only recommendatory in nature and do not bind the states. The state governments enjoy the option to accept or reject all or some of the recommendations put forth by a SFC (Alok, 2021).

Trends in functioning of SFCs

In compliance with the constitutional mandate, ideally every state should have constituted their 6th SFC in 2019-20 operating from 2020-2021 to 2024-2025. Unfortunately, this has not happened in practice. Only nine out of 28 states have managed to constitute their 6th SFCs which were due in 2019-20. These states are Kerala (2021–22 to 2025–26), Tamil Nadu (2022-23 to 2026-27), Rajasthan (2020-21 to 2024-25), Assam (2020-21 to 2024-25), Bihar (2020-21 to 2024-25), Punjab (2021-22 to 2025-26), Haryana (2021-22 to 2025-26), Sikkim (2025-26 to 2029-30), and Himachal Pradesh (2022-23 to 2026-27). Out of these states, Sikkim could constitute its 6th SFC only in June 2022 covering the financial year 2025-2029 (Finance Dept. Notification Govt. of Sikkim, 2022).

Evidently, not all states have established their 6th SFC, and not all of those that did were able to constitute it on time. Even for those who did, it is clear that there is a noticeable difference in the duration of their 6th SFC award period. For instance, the 6th SFC award period for Rajasthan, Assam, and Bihar is 2020-2021 to 2024-2025 whereas the award period for the 6th SFC of Kerala, Punjab, and Haryana is 2021-22 to 2025-26.

On the other hand, several states have not yet progressed beyond their 3rd and 4th generation SFC (See Table 1). For instance, Nagaland constituted its 3rd SFC in March 2023 to make recommendations covering only 3 years period, commencing on the 1st of April 2023 to 31st of March 2026 (Gogoi, 2023). Meghalaya has not constituted even its 1st SFC as of now. The state has already enacted the Meghalaya State Finance Commission Act, 2012 and framed the Meghalaya Finance Commission Rules, 2013 for the constitution of SFCs. However, even after a decade, Meghalaya has failed to constitute a SFC as per Section 10 of the Act (Meghalaya State Finances Audit Report of CAG, 2023).

Moreover, significant variation in the composition of SFCs has been witnessed. Since the formation of SFCs is contingent upon State-specific legislations, their composition varies not only across different states but even within different SFCs of the same state. For instance, the 6th SFC in Kerala was composed of a chairperson and two other members (Finance Department Notification Government of Kerala, 2019). The 3rd SFC of Haryana comprised of one chairperson and four other members (*Report of Third Haryana State Finance Commission*, 2008) whereas the 5th SFC of Haryana was formed with one chairperson and seven other members (*Report of Fifth Haryana State Finance Commission*, 2017).

Further, many states have failed to reconstitute their SFC at an interval of every five years as required. Even in cases where the SFCs have been timely constituted, there has been a lack of consistency in the approach taken by the SFCs when preparing their reports as per their Terms of Reference

Table 1: States with their last constituted SFC

States	*Last constituted SFC*
Kerala, Assam, Himachal Pradesh	Seventh
Bihar, Punjab, Rajasthan, Haryana, Tamil Nadu, Sikkim	Sixth
Madhya Pradesh, Maharashtra, Manipur, Odisha, Uttarakhand, Uttar Pradesh, West Bengal, Andhra Pradesh, Karnataka, Jharkhand	Fifth
Tripura, Chhattisgarh	Fourth
Goa, Gujarat, Nagaland	Third
Arunachal Pradesh, Mizoram	Second
Erstwhile Jammu and Kashmir, Telangana	First

[Source: Author's own compilation from State Government websites and Report of the Standing Committee on Rural Development and Panchayati Raj, 2023]

2 *See* Preambles of the Bihar Panchayati Raj Act, 2006 & The Bihar Municipal Act, 2007.

3 Section 28 of the Bihar Panchayati Raj Act, 2006 Section 71 of the Bihar Municipal Act, 2007.

Table 2: Time taken by SFCs to submit 6th SFC reports

S. No.	*States*	*SFC*	*Award Period*	*Appointment Date (ToR)*	*Date of Submission (ToR)*	*Actual Submission Date*	*Delay in submission*	*Total Time Taken*
1.	Assam	First	1996–97 to 2000–01	23-06-1995	31-12-1995	February 1996	2 months	8 months
		Second	2001–02 to 2005–06	18-04-2001	31-10-2001	August 2003	1 year 10 months	2 years 4 months
		Third	2006–07 to 2010–11	06-02-2006	31-12-2006	March 2008	1 year 3 months	2 years 1 month
		Fourth	2011–12 to 2015–16	23-04-2010	31-12-2010	February 2012	1 years 2 months	1 year 10 months
		Fifth	2016–17 to 2019–20	05-03-2013	30-04-2014	November 2016	2 years 7 months	3 years 8 months
		Sixth	2020-21 to 2024-25	09-11-2018	30-10-2019	February 2020	4 months	1 year 3 months
		Seventh	2025-26 to 2029-30	01-07-2024	16-12-2024	NA	NA	NA
2.	Bihar	First		April 1994	Not submitted			
		Second	1998–99 to 2002–03	June 1999	November 2004			
		Third	2005-06 to 2009–10	July 2004		November 2007		3 years 4 months
		Fourth	2010–11 to 2014–15	June 2007		June 2010		3 years
		Fifth	2015-16 to 2019- 20	13-12-2013	31-03-2015	February 2016	11 months	2 years 2 months
		Sixth	2020-21 to 2024-25	20-02-19	31-02-2020	April 2021	1 year 2 months	2 years 2 months
3.	Punjab	First	1996-97 to 2000-01	April 1994		December 1995		1 year 8 months
		Second	2001-02 to 2005-06	September 2000		February 2002		1 year 5 months
		Third	2006-07 to 2010-11	September 2004		December 2006		2 years 3 months
		Fourth	2011–12 to 2015–16	November 2008		May 2011		2 years 6 months
		Fifth	2016-17 to 2020-21	18-09-2013	31-12-2015	June 2016	6 months	2 years 9 months
		Sixth	2021-22 to 2025-26	03-07-2018	31-12-2020	January 2021	1 month	2 years 6 months
4.	Rajasthan	First	1995-96 to 1999-2000	23-04-1994	30-09-1994	December 1995	1 year 3 months	1 year 8 months
		Second	2000-01 to 2004-05	07-05-1999	31-12-1999	August 2001	1 year 8 months	2 years 3 months
		Third	2005-06 to 2009-10	15-09-2005	30-06-2007	February 2008	8 months	2 years 5 months
		Fourth	2010-11 to 2014-15	13-04-2011	31-12-2011	September 2013	1 year 9 months	2 years 5 months
		Fifth	2015-16 to 2019-20	30-05-2015	30-11-2015	November 2018	3 years	3 years 6 months
		Sixth	2020-21 to 2024-25	12-04-2021	October 2022	21-09-2023	11 months	2 years 5 months
5.	Kerala	First	1996-97 to 2000-01	23-04-1994	April 1995	February 1996	10 months	1 year 10 months
		Second	2001-02 to 2005-06	23-06-1999	June 2000	June 2001	1 year	2 years
		Third	2006-07 to 2010-11	20-09-2004		November 2005		1 year 2 months
		Fourth	2010–11 to 2015–16	September 2009		March 2011		1 year 6 months
		Fifth	2016–17 to 2020–21	17-12-2014	December 2015	March 2016	3 months	1 year 3 months
		Sixth	2021–22 to 2025–26	31-10-2019	October 2021	December 2021	2 months	2 years 2 months
		Seventh	2026-27 to 2020-31	11-09-2024	NA	NA	NA	NA
6.	Sikkim	First	2000-01 to 2004-05	22-07-1998		August 1999		1 year 1 month
		Second	2005-06 to 2009-10	05-07-2003		September 2004		1 year 2 months
		Third	2010-11 to 2014-15	04-03-2009	November 2009	February 2010	3 months	11 months
		Fourth	2015–16 to 2019–20	June 2012	December 2012	May 2013	5 months	11 months
		Fifth	2020-21 to 2024-25	17-08-2016	28-02-2017	July 2017	5 months	11 months
		Sixth	2025-26 to 2029-30	20-06-2022	31-12-2023	February 2024		
7.	Himachal Pradesh	First	1996-97 to 2000-01	23-04-1994		November 1996		2 years 7 months
		Second	2002-07	May 1999		October 2002		3 years 5 months
		Third	2007-08 to 2011-12	26-05-2005		November 2007		2 years 6 months
		Fourth	2012–13 to 2016–17	May 2011	31-12-2011	January 2014	2 years 1 month	2 years 8 month
		Fifth	2017-18 to 2021-22	19-11-2014	30-04-2016	January 2018	1 year 9 months	4 years 2 months

		Sixth	2022-23 to 2026-27	22-08-2020	31-12-2021	October 2022	10 months	2 years 2 months
		Seventh	2027-28 to 2031-32	01-03-2024	NA	NA	NA	NA
8.	Tamil Nadu	First	1997-98 to 2001-02	23-04-1994		November 1996		2 years 7 months
		Second	2002-03 to 2006-07	03-03-2000		May 2001		1 year 2 months
		Third	2007-08 to 2011-12	14-12-2004	May 2006	September 2006	4 months	1 year 9 months
		Fourth	2012–13 to 2016–17	December 2009	31-05-2011	September 2011	4 months	1 year 9 months
		Fifth	2017-18 to 2021-22	01-12-2014	31-05-2016	December 2016	7 months	2 years
		Sixth	2022-23 to 2026-27	06-03-2020	31-07-2021	February 2022	7 months	1 year 11 months
9.	Haryana	First	1997-98 to 2000-01	31-05-1994	30-05-1995	March 1997	1 year 10 months	2 year 10 months
		Second	2001-02 to 2005-06	06-09-2000	31-12-2000	September 2004	3 years 9 months	4 years
		Third	2006–07 to 2010–11	22-12-2005	31-12-2006	December 2008	2 years	3 years
		Fourth	2011–12 to 2015–16	16-04-2010	31-03-2011	June 2014	3 years 3 months	4 years 2 months
		Fifth	2016-17 to 2020-21	26-05-2016	30-05-2017	September 2017	4 months	1 year 4 months
		Sixth	2021-22 to 2025-26	22-09-2020	September 2021	December 2021	3 months	1 year 3 months

[Source: Author's own compilation from SFC reports and government websites]

(ToR). There has been a considerable variation in the time taken by SFCs to submit their report (See Table 2). This has been witnessed not only among SFCs of different states but even between SFCs within a state (Alok, 2021; Table 2). For instance, the 4th SFC of Haryana took over four years to submit its report whereas the 5th SFC of Haryana took one year four months to submit its final report (See Table 2).

Additionally, in some cases, despite the formation of the SFC, its reports remain unavailable in the public domain. For instance, Jharkhand, a State formed in 2000, has established all three potential SFCs, yet none of these reports are publicly available (Rai, 2018).

SFCs also lack a uniform methodology for assessing the revenues and needs of local bodies, as well as the financial resources available to the states to support the local bodies. This has posed a challenge for the UFCs to consider the SFC recommendations (Reddy & Reddy, 2019). For instance, according to the Report of the 13th UFC, the 1st SFC for Maharashtra (1994-1997) made comprehensive recommendations regarding the specific revenues collected by the State Government. According to these recommendations, 10% of the professional tax collected by the State Government was to be given to local bodies (Report of Thirteenth Finance Commission, 2009); 66.67% of the demand of land revenue and cess thereon was to be given to Panchayati Raj Institutions as advance grants (Report of Thirteenth Finance Commission, 2009); irrigation cess grant equal to 66.67% was to be given to Zilla Parishads as advance grants, 25% of net income from motor vehicle tax be given to urban local bodies (Report of Thirteenth Finance Commission, 2009). To the contrary, the 2nd SFC for Maharashtra (1999-2002) recommended a global sharing of revenues whereby 40% of the State Government's tax, duties, tolls and proceeds be given to the local governments (Asher & Sheikh, 2016).

Moreover, there have been variations in the manner SFCs have recommended devolution of funds to local bodies. In some instances, states have specified block amounts that were to be devolved to panchayats and municipalities. For instance, the 1st and 2nd SFCs of Himachal Pradesh (award period 1996-97 to 2000-01 and 2002-03 to 2006-07) recommended a fixed sum to be devolved to local bodies (*Report of Fifth Himachal Pradesh State Finance Commission*, 2018). Additionally, the report of the 13th UFC also noted that the 1st SFC of Odisha (1997–98 to 2004–05) recommended the state to bear the full salary and other cost of staff of Panchayati Raj Institutions as devolution to rural local bodies (Report of Thirteenth Finance Commission, 2009). However, the report suggests that the 2nd SFC of Odisha (2005–06 to 2009–10) recommended that 10% of average of state's gross own tax revenue (1999-2000 to 2001-02) be devolved to local bodies and recommended that the grants-in-aid for certain specified objectives be calculated as 10% of the state's gross own tax revenue (2002-03) minus the devolvable amount (Report of Thirteenth Finance Commission, 2009).

Additionally, the untimely delays in the formation of SFCs in almost all states have made the SFC reports non-synchronised with the UFCs. According to the constitutional mandate, the UFC shall propose measures to enhance the consolidated funds of states on the basis of the recommendations of the SFCs. However, in doing so the UFCs have faced several limitations due to the non-availability of the SFC reports for the relevant period and non-synchronization of the SFC reports with the UFC award period. The 15th UFC has recommended that following March 2024 the release of grants should be restricted to only those

States that have duly constituted the SFCs in accordance with the constitutional mandate (*Report of Fifteenth Finance Commission*, 2021).[4] However, the 15th UFC's recommendation has not made much of a difference. The 16th UFC has been constituted in India to make recommendations for the years 2026-27 to 2030-31 *Sixteenth Finance Commission of India*, 2024). However, until now SFCs from only nine states (Assam, Bihar, Punjab, Rajasthan, Kerala, Haryana, Tamil Nadu, Himachal Pradesh, Sikkim) have successfully submitted their reports.

The above examples highlight the variation in the constitution, the award period and the time taken to prepare the report and the diversity in the nature of recommendations made by SFCs of different states and successive SFCs within the same state. Consequently, the non-standardisation in the formation and recommendation and non-synchronisation of SFC reports with the UFC has made it difficult for successive UFCs to base their recommendations on SFC reports.

Challenges in the functioning of SFCs

Besides issues with the timely constitution and lack of standardisation of SFC reports, various concerns have arisen around the functioning of the SFCs. This section outlines some of the most prominent issues that interfere with the working of the SFCs across states.

The fact that the SFCs are not permanent institutions, rather, they form every five years and then dissolve after submitting the report, presents one of their biggest challenges. SFCs thus lack a permanent and dedicated office space, necessary equipment such as computers, furniture, and other logistical assistance upon their constitution (Chakraborty et al., 2018). Thus, the Commission loses a significant amount of time before they can properly begin their work. For instance, this challenge has been thoroughly documented in the fourth SFC report of Karnataka (Chakraborty et al., 2018). The Commission noted that upon their appointment, akin to earlier SFCs in Karnataka, they faced substantial administrative hurdles in establishing an office space and guaranteeing the smooth operation in its initial phases (Chakraborty et al., 2018).

Besides, another challenge has been the absence of reliable data for SFCs to base their analysis and inference upon. The non-availability of data on local body finances has closely correlated with the delay in SFC report submission. Most SFCs have mentioned this challenge in their reports (Alok, 2021). Neither the local government departments nor the State or Union ministries and departments nor the NITI Aayog have consistent data on local revenue and expenditure of local bodies, or the funds transferred to them from upper levels of governments (Alok, 2021). It is equally difficult to find data related to assignments of functions and taxes from the state government. Given that SFCs are temporary institutions, new SFCs could not benefit from the data collected by the previous SFCs. Thus, every new SFC has an additional task of collecting the requisite data from the state and local governments. As a result, considerable time is spent on re-designing information formats and questionnaires for data collection which leads to delay in report submission (Chakraborty et al., 2018).

Moreover, the composition of SFCs has been another concern. Unlike Article 280 of the Constitution, that clearly states the membership of the Finance Commission to be the chairperson along with 4 other members, the constitution leave the membership of the SFCs to the discretion of states. Hence, the number of members in a SFC varies across states. A study conducted by the *Society for Participatory Research in Asia*, found that State Governments usually constitute SFCs under the chairpersonship of a senior politician, or a retired bureaucrat or a reputed economist/academic, and often the other appointed members are serving bureaucrats (Rai, 2018). This highlights a common practice among states to designate current government officials as chairpersons and members of the SFCs, often in ex-officio roles (Gupta & Chakraborty, 2019). This imposes constraints on the ability of the SFCs, a statutory body constituted for independently suggesting the mechanisms to decide upon devolution of resources from state to the local governments, to act autonomously in a free and independent manner, as has been envisioned in the Constitution (Gupta & Chakraborty, 2019). In such circumstances, the larger issue concerning the autonomy and independence of the Commission draws attention.

It has been noted that several state governments do not abide by the recommendations of the SFCs. Articles 243I(4) and 243Y(2) mandates that the state government shall present before the Legislature of the State every recommendation made by the respective SFC together with an explanatory memorandum as to the action taken thereon. The provision is akin to Article 281 which relates to the action taken by the union government on the UFC recommendations. However, states tend to ignore this mandate and pay little attention to the recommendations of the SFCs and at times even reject it (Alok, 2021). For instance, Maharashtra, Sikkim, Gujarat, Haryana, and Karnataka are a few states that have rejected more recommendations of SFCs as compared to what they have accepted (Rai, 2018). This is because, just like UFC recommendations, the SFC recommendations are also recommendatory only. The states are not bound by the recommendations of SFCs and therefore they may accept or reject all or some recommendations of the SFC. However, a healthy practice has been adopted at the union level where all UFC recommendations are accepted by the Parliament (Alok, 2021).

4 The 12th UFC recommended that the SFC reports should be available at the time of constitution of the UFC to make it easier for the Commission to assess the SFC reports based on uniform principles.

Conclusion

The objective behind the institutionalisation of SFCs was to ensure decentralisation and local self-governance. It was intended to address the lack of institutional oversight at the subnational level regarding the transfer of funds from states to local governments as well as help the local governments plan for economic development and deliver social justice and public services. Nevertheless, the SFCs have not yet reached their full potential.

Multiple challenges have hindered the operational efficiency of SFCs in various states. In addition to the procedural inconsistencies in the qualification and composition of SFCs as well as the varying submission times for SFC reports, there is another issue that has had a direct impact on devolution. This issue is the lack of synchronisation between SFCs and the UFC award period.

As discussed in the previous sections, the Constitution of India, aims to synchronise the recommendations of the UFC with the SFC recommendations of all states. As initially planned, the UFCs shall provide recommendations on ways to enhance the Consolidated Fund of a State to support the resources of Local Governments based on the recommendations made by SFCs. However, the UFCs have been unable to capitalise on SFC recommendations due to the delayed formation of SFCs by most state governments.

It is worth mentioning that local governments in India have a meagre revenue base and are highly dependent on devolution from the union and state governments. As a result, the SFC reports are of utmost importance for unrestricted transfer of funds to the local governments so that they can contribute to a sustainable future. Thus, the State Government that appoints the SFC has a crucial responsibility to enhance the quality of support provided to the SFCs and increase the credibility of their reports. Unfortunately, the majority of states have not made significant improvements to the conditions that affect their functioning of the SFCs. Several states have caused unusual delays in the constitution of SFCs. Moreover, once the SFCs has been established, there has been considerable delay in submission of SFC reports as well as presenting of action taken reports before the State Legislatures in most states (*Report of Thirteenth Finance Commission*, 2009). In a study conducted by the National Institute of Public Finance and Policy (NIPFP), commissioned by the 15th UFC, it has been found that the average delay in SFCs submitting their report has been around sixteen months (*Report of Fifteenth Finance Commission*, 2021). As a result, this leaves very little time out of the award period for implementation of the recommendations of SFCs (Gupta & Chakraborty, 2019). Successive Finance Commissions at the centre, such as the 13th, 14th, and 15th UFCs, have expressed concern over the fact that the members and chairperson of SFCs often lack professionalism and required aptitude. On the other hand, the State Governments have often questioned the quality of SFC reports and used this as a reason for not accepting their recommendations. The delay caused by the states in considering SFC recommendations has further contributed to the non-synchronisation SFC reports with that of the UFCs. All these and several other factors have impeded the SFCs from attaining their intended objectives under the constitution.

The 13th and 14th UFCs have recognised that because of variations in the approaches adopted by the SFCs, difference in the periods covered by individual SFCs, non-synchronisation of the SFCs report period with that of the Finance Commission report, and the questionable quality of SFC reports, UFCs have been unable to base their recommendations entirely on SFC reports. Moreover, because of issues concerning non-standardisation in the manner of constitution and functioning, and the format of reports of SFCs across different States, SFCs have not been instrumental in ensuring adequate fiscal devolution to local governments.

There have been several appeals for reforming the SFCs. Interestingly, the 15th UFC has recommended that the SFC reports be made a precondition for release of grants to local bodies after March 2024 (Pradhan & Kotasthane, 2021). Thus, it has made the release of local grants conditional on states compliance with the constitutional provisions regarding SFCs. However, without synchronised SFC reports from all states, the 16th UFC may face a disadvantage to its predecessors.

There is potential for improvement in the functioning of SFCs which can be achieved through collaborative efforts between the union and state governments, as well as the SFCs themselves. The Parliament shall contemplate allocating some powers to the SFCs through a constitutional amendment. The fact that SFCs were envisaged as a constitutional entity to further local self-governance shall guide the scope of the tasks assigned to the SFCs under the constitution. Towards that end, the SFCs shall be mandated to consider the finances of the local body against their functional responsibilities under Articles 243G & 243W as well as underline principles that deepen democracy. Moreover, synchronisation of the SFCs with the UFC period shall be made mandatory. The allocation of grants to the local governments from the UFCs and union ministries shall be supervised by way of regular evaluation of distribution of funds among local bodies by SFCs and states.

The state governments on the other hand shall aim to synchronise SFC with the UFC award period. For this the state shall constitute SFCs without delay and set a strict time frame for the constitution of SFC, submission of the report and implementation of the recommendations made by the SFC. The states shall also aim to standardise the composition of the SFC and adopt best practices to determine a standard qualification of members to ensure that SFCs function as an independent and autonomous institution as envisaged by the constitution. Moreover, a uniform methodology shall be developed by all states to analyse the revenue needs of the local bodies and the financial resources available with the states to support the local bodies. Additionally, the states should strive to maintain public records and reliable data on local bodies.

Strictly speaking, SFCs while analysing the financial devolution to the local bodies must remain mindful of the functional devolution and administrative devolution in the state. The SFCs should adhere to uniform methodology and approaches that are well defined and explained. The data collected by the SFC, or the studies commissioned by the SFCs should be made accessible to the public and every state should maintain a well-designed easily navigable SFC website that encompasses all SFC reports and related documents to facilitate communication.

These endeavours and reforms should greatly contribute to ensuring that SFCs effectively carry out their constitutional responsibilities and operate as an independent constitutional body that guarantees unhindered financial decentralisation to local governments so that the local governments can meaningfully contribute to a sustainable future.

Funding

The authors received no financial support for the research, authorship and/or publication of this paper.

Acknowledgment

We thank anonymous referee for providing us with insightful remarks and meaningful suggestions.

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