International Journal of Computing and Business Research (IJCBR)

ISSN (Online) : 2229-6166

Volume 4 Issue 3 September 2013

# PLANNING COMMISSION AND FINANCE COMMISSION IN INDIA

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**Abstract**

India is a Union of States having federal system of finance. All sources of income and expenditure stand distributed amongst the Union government, State government and local governments, in the form of Central List, State List and concurrent List. The Constitution of India provides for the appointment of finance commission after every five years, even though new finance commission can earlier be appointed by the President of India. Thus it is a continuous process. Finance Commission generally presents its recommendations with regard to allocation of revenue between the Centre and the States. On the other hand Planning Commission help in the formulation of the State Plans, tries to fit them, in an overall perspective of the nationwide strategy of economic growth. For the smooth working of the system some sort of co-ordination should exist between the Finance Commission and the Planning Commission.

## Introduction

Article 280 of the Constitution of India provides for an independent quasi-judicial expert body, known as the Finance Commission, for recommending the principles and proportions of financial transfers from the Union to the States through the 'built-in' balancing devices. The role of the Finance Commission is governed by the basic principles of federal finance, which seeks to meet the residuary budgetary needs of the States, after taking into account the devolution of the proceeds of the Union taxes to the States. The underlying idea is that the constituent units, being at different stages of development, need to be brought upto a minimum level, thereby aiming at 'equal sacrifice and equal opportunity'. In the light of this basic principle, the various Finance Commissions devised their own schemes for determining the quantum of statutory assistance to the States. By and large, the emphasis has been on the need to meet the budgetary gaps of the States.

## Objectives

To study role of Finance Commission

To study how the Planning and Finance Commission are working simultaneously

The process of planned economic development has changed, however, the entire fiscal context in the economy since 1951-52. The criterion of 'budgetary needs', implicit in the Finance Commission's recommendations, was put into insignificance by the impact of Plan expenditure, growing as it did in all these years of economic planning. The formulation of Plans at the State's level, their incorporation in the national Plans and their implementation at the State's level, formed a big charge on the Union exchequer, in fact, if not in theory. The tax sources of the States having been relatively narrow and inelastic, their financial resources for putting through the Plan schemes had to be supplemented by increasing assistance from the Union. Consequently, the criterion of the 'budgetary needs' - a concept which considers the gap in current revenues and expenditures for allocation of Union assistance – gave way to the concept of 'fiscal needs'. The latter concept is of much wider economic significance, which interprets the gap in resources in an overall context of total expenditure of the State.

This gradual, but perceptible, change in the Union-States' financial relationship influenced, to a considerable extent, the thinking of the successive Finance Commissions. The Finance

Commissions recognized the need to take into account not only the 'budgetary needs' but also the 'fiscal needs' arising out of the execution of development but most of them were guided by its terms of reference to take only non-Plan expenditure into account, calculated the non-Plan revenue gap on the basis of its scrutiny of the estimates submitted by State governments and recommended its complete elimination through Union assistance.

The limitation of the scope of the recommendations of the Finance Commission to take into consideration the non-plan requirements of the States while putting up its recommendations, and as a consequence leaving the mode, quantum and criteria for allocation of resources of plan expenditures to be determined by the Planning Commission, has not been effected by any amendment of the Constitution, but only by altering the limitations arising out of the terms of reference, there is nothing to preclude the Finance Commission to take into consideration requirements arising out of plan expenditures too. "Nowhere in any clause there is an express or implied indication that the total revenues of a State should be utilized only for revenue expenditure. . . . . . It is abundantly clear to my mind that the reference in the main part of clause (1) of Article 275 to grants-in-aid to the revenues of States is not confined to revenue expenditure only . . . There is no legal warrant for excluding from the scope of the Finance Commission all capital grants; even the capital requirements of a State may be properly met by grants-in-aid under Article 275(1), made on the recommendations of the Finance Commission . . . The legal position, therefore, is that there is nothing in the Constitution to prevent the Finance Commission to take into consideration both capital and revenue requirements of the States in formulating a scheme of devolution and in recommending grants under Article 275 of the Constitution.

The role of Planning Commission with regard to the allocation of Union assistance to the States is, without doubt, much wider and in terms of magnitude more effective and decisive. Precisely speaking, its role is confined to the needs arising out of additional current outlays and the total expenditure on capital account, which is projected while formulating the Five Year Plans. The Planning Commission help in the formulation of the State Plans, tries to fit them, in an overall perspective of the nationwide strategy of economic growth. For the purpose, it considers the budgets of the State governments in their entirely including the non-Plan revenue and capital expenditure and then the quantum of the Union assistance to the States is determined. To that extent, two considerations are borne in mind: (1) the gap in the State Plans, after allowing for

traditional taxation and borrowing; and (2) the commitment involved in fulfilment of the Centrally sponsored schemes, embodying therein the matching principle.

A report, on the basis of report of the working group on State Finances and Centre-State Financial Reforms, Point out the following developments and contradictions which may arise because of the working of two commissions simultaneously without any coordination.

Firstly, the estimates submitted by the State governments to these two bodies are not consistent. As the Finance Commission is engaged in filing the 'revenue gap', there is a temptation for the State to present figures, which underestimate their resources. On the other hand, under pressure to increase their Plan size and show the necessary resources for them in their submissions to the Planning Commission, they consistently overestimate their resource-raising potentialities and capabilities at current rates of taxation and prices and underestimate their non-Plan expenditure liabilities, as the more they undertake to raise, the more they are likely to get. Considering that the process of Plan formulation has not generally coincided with the deliberations of the various Finance Commissions (except in respect of the fourth Commission) it is not very difficult for the State governments to give two sets of figures to these bodies.

Secondly, the functioning is isolation of these two Commissions leads some relatively more developed States to fudge the figures. Since the statutory assistance under the Finance. Commission's awards is given to those States which have a gap in their non-Plan revenue account, these States are either listless and indifferent to the Finance Commission or if at all they show any interest, they manoeuvre a gap in the revenue account. The approach is reserved when they place the case before the Planning Commission.

Thirdly, following from the above, the distinction between Plan expenditure and non-Plan expenditure, drawn by the two Commissions for the purpose of allocation of Central assistance, leads to a considerable amount of manoeuvre on the part of the States and the resultant confusion.

Fourthly, when the Plan expenditure is continuing and is progressively increasing, the non-Plant expenditure, in so far as it is functionally related to the Plan expenditure, also increases likewise. It is added, therefore, that the datum which one body considers as relevant is totally ignored by the other. Since it is the total expenditure which is pertinent, it should be the total assistance that must be the concern of any body charged with the allocation of Central assistance.

Finally, the major objective of statutory assistance is to bring up the backward States to a minimum level in relation to the relatively more developed States. The incidentally is also one of the Planning Commission. In order to aim at balanced regional development.

It will be observed, therefore, that the dichotomy in the functions of the two bodies, the Finance Commission and Planning Commission, in determining simultaneously the quantum of Union assistance to the States has not resulted either in allocation among States consistent with the Plan objectives. "One of the main objectives Central assistance to States has been to ensure that the States implement effectively those schemes and projects which have a certain rationale in the overall context of the national economy. In other words, the pattern of assistance devised was designed to facilitate the use of Central funds in channels pre-determined in the Plan. When it was found that these objective were not achieved on account of lacunae in the procedures underlying the release of Central assistance, many reforms were introduced to simplify the procedures. Even then the main objective of ensuring that the funds were used so as to achieve certain results has remained largely unfulfilled. Instead what has been achieved in an artificial uniformity in the schemes and projects of different States.

From it may be suggested that some sort of co-ordination should exist between the Finance Commission and the Planning Commission. To avoid overlapping it is necessary that the period covered of the recommendations of the Finance Commission should correspond to that of the five year plans and the assessment of the States, both on rename and capital accounts, should be made by one Commission and in coordinate with the other.

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