Know your Budget Series

ROLE AND RELEVANCE OF PLANNING COMMISSION AND FINANCE COMMISSION

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Two institutions that play a key role in influencing the scope of budgetary spending by the Union Government and State Governments are Planning Commission and Finance Commission. The Indian Constitution provides for the necessary institutional framework, financial and functional division of responsibilities between the Centre and the states, and a defined mechanism for intergovernmental transfer to address the existing vertical and horizontal imbalances.

(**Vertical imbalances** refer to the mismatch between the revenue-raising capacity and expenditure needs of the Centre and the States. **Horizontal fiscal imbalances** exist on account of the inability of some States to provide comparable services due to inadequate capacity to raise funds. To address these imbalances, the Finance Commissions have been given a constitutional mandate to decide on (i) the proportion of tax revenue to be shared with the States and (ii) the principles which should govern the grants-in-aid to States.)

There are three main channels that govern the fiscal transfers from Centre to state. First, the Finance Commission determines the state's share in Central taxes and grants out of the Consolidated Fund of India. Second, the Planning Commission makes recommendations on the magnitude of grants and loans to be provided to the states for financing their expenditure on the targeted interventions for socio-economic development. Third, Central Sector schemes and Centrally Sponsored Schemes (CSSs) are designed by various Central government ministries in consultation with the Planning Commission, in which, the Centre's funds are transferred to the states implementing the schemes.

Finance Commission

Articles 270, 273, 275 and 280 of the Constitution of India provide for the formation of a Finance Commission (at the interval of every five years) to recommend to the President certain measures relating to the distribution of financial resources between the Centre and the States. Hence, the President appoints (at the interval of every five years) a Finance Commission comprising five members, including the Chairman, following certain Constitutional guidelines (about the qualifications/experience of the people to be appointed as members). The First Finance Commission was constituted in 1951, which had submitted its report in 1953 (Refer to table 1 for list of Finance Commissions in India).

Recently, the 14th Finance Commission has been constituted. The recommendations of this Finance Commission would be implemented by the Centre during 2015-16 to 2019-20.

The most important recommendations made by the Finance Commission are those relating to: the distribution of the tax revenue mobilized under the Central tax system between the Centre and the states; the allocation of the respective shares of such tax revenue among the different states; and the principles which should govern the grants-in-aid for the states to be provided out of the Consolidated Fund of India.

Planning Commission

The Planning Commission is not mentioned in the Constitution of India. It was set up as an advisory and specialised institution by a Resolution of the Government of India in March 1950. The Planning Commission has the responsibility of making assessment of all resources of the country, augmenting deficient resources, formulating Plans for the most effective and balanced utilization of resources and determining priorities.

The Prime Minister of the country is the Chairman of the Planning Commission. The Deputy Chairman and the full time members of the Commission, as a composite body, provide advice and guidance to the different subject Divisions (in the Planning Commission) for the formulation of Five Year Plans and Annual Plans, both at the national level as also for different States.

The Planning Commission is supposed to work under the overall guidance of the National Development Council. The working of the Planning Commission led to the setting up of the National Development Council (NDC) in 1952, as an adjunct to the Planning Commission, to associate the states in the formulation of the Plans. Since mid-1967, all members of the Union cabinet, Chief Ministers of States, the Administrators of the Union Territories and members of Planning Commission have been members of the NDC. The role of the NDC in determining the Plan priorities is critical as it integrates the views and expectations of the State Governments.

The most important suggestions made by the Planning Commission are those relating to: the magnitude of funds to be given from Union Budget to different States and Union Territories as 'Central Assistance for State and UT Plans', and the magnitude of funds to be given to Central Government Ministries/Departments for Plan expenditure on the Central Sector Schemes.

The Planning Commission makes an assessment of the availability of own resources with a State Government and its capacity to utilize Plan funds before finalizing the size of the State Plan. Once the size of the State Plan is decided, the Planning Commission recommends the Centre to provide some financial assistance to the State for its State Plan, which is also formula-based.

Both the institutions, i.e. Finance Commission and Planning Commission, play equally vital roles in terms of devolving funds and working towards reducing regional imbalances in the country. While the Finance Commission is constituted periodically and works for a couple of years (before it submits its Report), Planning Commission ensures that continuous appraisal and adjustments that are essential in the dynamic process of planning for a country as diverse as India is taken care of.

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