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Introduction

India follows a federal system of government, where financial relations between the Centre and States play a crucial role in maintaining a balance of power and resources. The financial distribution framework is primarily governed by the Constitution of India, which lays out provisions for taxation, grants, and revenue sharing. Given the diverse economic conditions of Indian states, financial relations between the Union and State governments are dynamic and continuously evolving.

Constitutional Provisions

The Constitution of India, under Part XII (Articles 268-293), provides a detailed structure for the financial relationship between the Centre and States. These provisions broadly cover taxation powers, grants-in-aid, borrowing powers, and financial responsibilities. The objective is to ensure fiscal autonomy to the States while maintaining a strong Centre to oversee national economic stability.

Distribution of Taxation Powers

The taxation powers between the Centre and States are categorized into three lists under the Seventh Schedule of the Constitution:

1. **Union List (List I):** Taxes that are levied and collected exclusively by the Central Government, such as:
 - Income Tax (except tax on agricultural income)
 - Customs Duties
 - Excise Duties (except on alcoholic liquors, narcotics, etc.)

- Corporation Tax
 - Service Tax (before GST implementation)
 - Central Goods and Services Tax (CGST) under the GST regime
2. **State List (List II):** Taxes that are levied and collected by State Governments, including:
- State Excise Duty (on alcoholic liquor, narcotics, etc.)
 - Land Revenue
 - Stamp Duty (except in matters under Union jurisdiction)
 - State Goods and Services Tax (SGST) under the GST regime
3. **Concurrent List (List III):** Certain taxes were part of both Centre and State domains, but with the implementation of Goods and Services Tax (GST), indirect taxation has largely been unified.
4. **Residuary Powers:** Any tax not mentioned in the three lists falls under the Centre's authority.

Finance Commission and Revenue Sharing

The Finance Commission, established under Article 280 of the Constitution, plays a vital role in recommending the distribution of revenue between the Centre and States. The Commission is constituted every five years and suggests:

- The division of net proceeds of taxes between the Union and States.
- The principles governing grants-in-aid to the States.
- Measures to augment the Consolidated Fund of a State to supplement the resources of Panchayats and Municipalities.

Grants-in-Aid

Apart from tax revenue sharing, the Centre provides financial assistance to States in the form of grants-in-aid under Articles 275 and 282. These grants can be:

- **Statutory Grants:** Recommended by the Finance Commission for specific needs, like special assistance for backward states.

- **Discretionary Grants:** Given under Article 282, at the discretion of the Central Government, mainly for welfare schemes and development projects.

Goods and Services Tax (GST) and its Impact

The introduction of GST in 2017 brought significant changes to financial relations. GST is a comprehensive indirect tax that replaced multiple State and Central taxes, ensuring a uniform tax structure across the country. The GST Council, a constitutional body under Article 279A, governs the division of GST revenues between the Centre and States.

Key aspects of GST's impact on financial relations:

- Elimination of multiple cascading taxes.
- States are assured compensation for revenue loss for five years under the GST (Compensation to States) Act, 2017.
- Greater financial interdependence between the Centre and States.

Borrowing Powers

The Centre and States have distinct borrowing powers under the Constitution:

- **Centre's Borrowing (Article 292):** The Union Government can borrow upon the security of the Consolidated Fund of India.
- **States' Borrowing (Article 293):** States can borrow within India, but require the Centre's consent if they have outstanding loans from the Union Government.

Financial Imbalance and Challenges

Despite a well-defined framework, financial relations between the Centre and States face several challenges:

- **Vertical Imbalance:** The Centre collects more revenue, while States bear higher expenditure responsibilities, leading to fiscal stress at the State level.

- **Horizontal Imbalance:** Wealthier States generate more revenue, whereas poorer States require more financial assistance, causing inequality.
- **Delayed Fund Transfers:** Often, Central allocations and grants to States are delayed, impacting developmental activities.
- **Disputes Over GST Compensation:** States have expressed concerns about delays in GST compensation, affecting their fiscal stability.
- **Debt Management Issues:** States often struggle with rising debt burdens due to over-reliance on Central grants and market borrowings.

Recent Developments and Reforms

To improve financial relations, the government has introduced several reforms:

- **14th and 15th Finance Commissions' Recommendations:** Increased the share of States in Central taxes from 32% to 42% (14th FC) and later to 41% (15th FC).
- **Atmanirbhar Bharat Scheme:** Allowed States to borrow more, with certain reforms linked to borrowing limits.
- **NITI Aayog's Role:** Replacing the Planning Commission, it facilitates cooperative federalism, providing policy advice and financial planning.

Conclusion

The financial relations between the Centre and States in India are critical for ensuring cooperative federalism. While the constitutional provisions provide a structured framework, challenges like fiscal imbalance and fund allocation disputes persist. Ongoing reforms, transparent financial policies, and improved Centre-State cooperation are essential to maintaining a balanced and efficient financial relationship in the country.

