

## CHAPTER VII

### PRINCIPLES OF GRANTS-IN-AID

*Constitutional provisions.*—The Finance Commission have been charged under Article 280 (1) (b) of the Constitution, with the duty of making recommendations to the President as to the principles which should govern the grants-in-aid of the revenues of the States out of the Consolidated Fund of India. Article 275 provides for the payment of such sums as Parliament may by law provide as grants-in-aid of the revenues of such States as Parliament may determine to be in need of assistance. The first proviso to Article 275 requires grants to be made to a State to enable it to meet the cost of schemes of development undertaken with the approval of the Central Government for the purpose of promoting the welfare of the Scheduled Tribes or to raise the level of administration of the Scheduled Areas in the State to that of the rest of the areas of that State. In regard to Assam, the second proviso requires the payment of a grant-in-aid equivalent to the average excess of expenditure over the revenues of the State during the two years preceding the commencement of the Constitution in respect of the administration of the tribal areas specified in Part A of the table in paragraph 20 of the Sixth Schedule, and the cost of such schemes of development as may be undertaken by that State, with the approval of the Government of India, for raising the level of administration of these areas to that of the rest of the areas of that State. Provision is made in Article 273 for grants-in-aid of the revenues of the States of Assam, Bihar, Orissa and West Bengal in lieu of their share of the net proceeds of the jute export duty.

2. We have dealt with the grants-in-aid in lieu of the share of jute export duty in an earlier chapter. In regard to the grants-in-aid under the provisos to Article 275, the principles of these grants are contained in the provisos themselves. The principles which we enunciate in this chapter would, therefore, concern the grants-in-aid of the revenues of States, under the substantive portion of clause (1) of Article 275.

3. *Scope of grants-in-aid of revenues.*—The term “grants-in-aid of the revenues” has not been defined in the Constitution. Both the Government of India Act, 1935, and the Constitution contain provisions under which assistance may be given to the States by way of grants. Section 142 of the Government of India Act provided for the payment of such sums as might be prescribed by His Majesty in Council as grants-in-aid of the revenues of such Provinces as His Majesty might determine to be in need of assistance, while Section 150 gave the

of the export duty were Rs. 968 lakhs and the divisible pool for that year at 62½ per cent would amount to Rs. 605 lakhs. The total quantity of raw jute exported in 1949-50 was 2.01 lakh tons and the raw jute used in the manufactured goods exported in that year (on the assumption\* that the manufacture of 1 ton of jute goods requires 29 maunds of raw jute) was 8.38 lakh tons. During that year the production of raw jute in these four States was:

	(In lakhs of tons)
West Bengal	2.59
Bihar	1.29
Assam	1.28
Orissa	0.26

As the basis of distribution, which has remained unchanged ever since the jute duty began to be shared, is the amount of jute grown, these four States cannot, in equity, lay claim to the whole of the divisible pool as a much larger quantity of jute than grown in these States went into the total exports for that year, taking raw jute and manufactured goods together. Even on the assumption that the entire production of these States went into exports in that year and that the demand for local consumption was met entirely from other sources, the *pro rata* share of these States in the divisible pool for that year would, in round figures, amount to:

	(In lakhs of rupees)
West Bengal	150
Bihar	75
Assam	75
Orissa	15

We recommend that these sums be prescribed as grants-in-aid payable annually to these States under Article 273 of the Constitution, with effect from 1952-53.

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\* Monthly Summary of Jute and Gunny Statistics.

Centre or a Province power to make grants for any purpose, notwithstanding that the purpose was not one with respect to which the Federal or the Provincial Legislature, as the case might be, might make laws provided the burden on the revenues was for the purpose of India or some part of India. Article 275(1) of the Constitution, in its substantive part, is worded similarly to Section 142 of the Government of India Act, 1935, while Article 282, except for the substitution of 'any public purpose' for 'any purpose' also follows the wording of Section 150 of the Government of India Act, 1935. Thus Article 282 permits the Union or a State to make grants for any public purpose notwithstanding that the purpose is not one with respect to which Parliament or the Legislature of a State, as the case may be, may make laws.

4. The grants made to the Provinces under Section 142 of the Government of India Act, 1935, the grants made to Assam, Punjab and Orissa so far under Article 275 of the Constitution and the grants made to the four jute-growing Provinces under Article 273, have been of the nature of unconditional assistance to the revenues of these States. All the grants have been made by formal orders issued in accordance with the provisions of the Constitution. The "revenue gap grants" made to Part B States under Article 278(1)(b) of the Constitution and similar grants to the Part A States in respect of "merged areas" have likewise been unconditional grants. Under the powers given to the Centre by Article 282 (and previously by Section 150 of the Government of India Act, 1935) large sums have in the past been made available to the States by way of specific grants and such grants still continue to be made. A reference to some of these grants is made later in the chapter.

5. It is possible to argue that the term "grants-in-aid of the revenues" should be construed as confining it to such grants as are intended for the augmentation of the revenues of the receiving State without any limitation as to how the money so made available should be spent. We consider that the problem has to be viewed in the larger perspective of securing an equitable allocation of resources among the units. We are, therefore, of the view that the scope of Article 275 or Article 280(3)(b) should not be limited solely to grants-in-aid which are completely unconditional; grants directed to broad but well-defined purposes could reasonably be considered as falling within their scope. In enunciating the principles which should govern grants-in-aid of the revenues of the States we accordingly propose to cover both general grants and grants for broad purposes.

6. Before we proceed to a consideration of the principles which should govern grants-in-aid of the revenues of the States, we refer

briefly to the grants-in-aid given in the past by the Central Government to the State Governments in India as well as the experience of other countries.

7. *General grants.*—The system of grants in India has had a fairly long history, some reference to which has been made in Chapter II. The system of Provincial assignments, which was in operation before 1919, was the earliest experiment in the field. The first statutory provision for grants-in-aid, however, came with the Government of India Act, 1935, under which grants-in-aid were given to Provinces in need of assistance. These were prescribed on the basis of Sir Otto Niemeyer's Report. Sir Otto Niemeyer made his enquiry preparatory to the coming into effect of a new constitution. He proceeded from the premise that each Province should be so equipped as to be able to enjoy a reasonable prospect of maintaining financial equilibrium, and in particular that the chronic state of deficit into which some of the Provinces had fallen should be brought to an end, consistently with the condition of not jeopardising the solvency of the Centre. He stated that in any country of the size of India there must inevitably be substantial differences in standards of administrative needs and possibilities just as there were in other areas of the same size elsewhere in the world, or for that matter even in much smaller units. He recognised that "some Provinces are intrinsically better off than others and at the moment less urgently in need of additional resources; and it is both fair and inevitable that a certain measure of corrective should be applied, even if it means that Provinces which have been able to attain higher standards of administration should now to some slight extent have to progress more slowly". Though he recognised the responsibility of the Provinces to look after their own budgets, he examined the budgetary position of the different Provinces and hence the needs of each Province, making necessary adjustments in the budget to make it reflect as far as possible the prospective position of a Province. He accordingly determined the measure of assistance which should be given to the various Provinces. This assistance, he recommended, should be afforded in various forms such as debt cancellation, increase in the share of the net proceeds of the jute export duty to be given to jute growing Provinces and grants-in-aid, either fixed or tapering, in the case of some Provinces. Grants-in-aid were thus based on an assessment of the final measure of need, being the amounts which were estimated to be sufficient to place the finances of the Provinces on an even keel, after taking into account all other forms of assistance including devolution of revenue and adjustment of debts.

8. Grants-in-aid which were recommended by Sir Otto Niemeyer were unconditional grants. The amounts were charged on the revenues of the Central Government and accrued as revenues to the

Governments of the units, and there was no question of the State Governments conforming to any conditions. Later, grants-in-aid amounting to Rs. 100 lakhs in 1947-48, Rs. 150 lakhs each in the following two years, and Rs. 75 lakhs in 1950-51 were made to Punjab under Section 142 of the Government of India Act.

9. *Other grants.*—Besides these general or unconditional grants, there were also other forms of grants given by the Centre, mainly of the specific type. The more important of these may be noticed briefly.

During the three years ending 1945-46 the Centre gave the Government of Bengal a total grant of Rs. 18 crores to assist them in meeting a part of the expenditure on famine and the subsequent rehabilitation measures.

From 1944-45 onwards, the Central Government have been giving the States substantial assistance for "Grow More Food" schemes. The grants are given on the basis of schemes of additional food production prepared by State Governments. Allocations of funds are not made to each State as such, but care is taken to see that "every State gets a fair share of the total block allocation, provided that the State has useful and productive schemes to execute". "The underlying principle is to produce the maximum quantity of foodgrains at minimum cost irrespective of regional considerations". Between the 15th August 1947 and 31st March 1952, these grants aggregated to Rs. 13.71 crores.

Another important category of grants was the post-war development grant. They were related to specific schemes of development in respect of which the State Governments were expected to contribute a proportion of the cost—usually one-half, but lower or nil in the case of certain Provinces like Orissa, Assam and Punjab. Between 15th August 1947 and 31st March 1950, when the grants were generally stopped, the total of these grants amounted to Rs. 38.32 crores.

Mention may also be made of the Special Development Grant of Rs. 3 crores to the four States of Saurashtra, Madhya Bharat, Rajasthan and Patiala and East Punjab States Union over the two years 1951-52 and 1952-53 for the purpose of financing specific development schemes to remedy their special backwardness, which is distributed largely on a population basis.

Under sub-clause (a) of the second proviso to Article 275, which requires a grant-in-aid to be paid to Assam, equivalent to the average excess of expenditure over the revenue during the two years immediately preceding the commencement of the Constitution in respect of the administration of certain tribal areas, a grant of Rs. 40 lakhs per annum is paid to the State. In addition, under sub-clause (b), a grant-in-aid of Rs. 36 lakhs in 1951-52 and Rs. 35 lakhs in 1952-53 is provided for payment to Assam for meeting the expenditure on

schemes of development. Under proviso (1) which prescribes grants for the development of scheduled tribes and areas, Rs. 24 lakhs and Rs. 124.8 lakhs were given in the years 1950-51 and 1951-52 respectively; the provision for 1952-53 is Rs. 135.5 lakhs.

A new category of grants is that relating to the community projects which involve recurring and non-recurring expenditure by State and Central Governments and sizeable grants by the Centre. Broadly, the scheme postulates a progressively diminishing contribution by the Central Government supplemented by an increasing contribution by the State Governments themselves.

10. *Experience of other countries.*—Both general or unconditional and specific or conditional grants have been used with comparative success in different countries and the debate on their relative merits continues. Unconditional grants have been tried and are in operation more prominently in Canada and Australia. Of these a type of grants which is of particular interest to us is that of 'special' grants in Australia. In that country where special grants are given to three States, called the claimant States, the principles of general grants-in-aid have been elaborated and refined to a greater degree than perhaps in any other country. The concept of the budgetary standard underlies the whole procedure of such grants. This is basically founded on the criterion of need, modified to ensure that a State receiving aid is not extravagant in its expenditure and does its best to tap its own sources of revenue. The modifications are applied by taking into account in the grants given any scope that may exist for reducing the expenditure or enlarging the receipts from taxation. Subject to these adjustments, the objective of grants is to enable the States obtaining them to function at a standard not appreciably below that of the States which do not claim any assistance. A margin is maintained on the ground that a State should not expect to be brought to a level of equality with other States which rely on their own resources and that a State's incentive to exert itself to better its position should be left unimpaired. But the system depends for its efficient functioning on an annual enquiry into and determination by the Commonwealth Grants Commission of the record of performance and needs of the States.

11. In other countries, specific grants are also given for the development of particular services and activities which are felt to be of national concern. Usually such grants are made subject to conditions of 'matching' the federal grants with equal or varying degrees of contribution by the States. While in Canada and Australia, the conditional grants exist side by side with the unconditional, in the U.S.A. they constitute virtually the only method of assistance to the States, the federal aid being channelled to the support of particular activities.

12. Wherever specific grants have been developed, the main case in favour of them rests on (1) the deficiency of States' resources in relation to functions; (2) the concern of the federal government in seeing that welfare services (*e.g.*, education, health, etc.) and developmental activities (*e.g.*, roads) are maintained at a certain minimum standard throughout the country; (3) the interest of the federal government in developing some activities which State Governments, left to themselves, might neglect (*e.g.*, unemployment insurance, social security, etc.); (4) the possibility of improving the quality of performance in the sphere of social services, owing to the superior technical advice available to the higher level of government; and (5) the desirability of some co-ordination of standards which can be achieved thereby.

13. It should be noted, however, that historically such grants became important owing to the first factor, *viz.*, deficient resources of States, at a time when the impact of a rapidly changing economic situation created large and insistent demands for new governmental services, though the interest of the federal government in maintaining certain minimum standards was responsible for the earliest excursions into the field.

14. The most important factors that appear to have influenced policy in the field of conditional grants are the increasing adaptation of these grants on the one hand to the ability or fiscal capacity of the units and on the other to their relative need for the specific services concerned. The former factor leads to the varying of the requirement to 'match' the federal grant with a State contribution so as to reduce the State contribution in the case of financially weaker States. The principle of need is, of course, innate in the purpose of a grant, and implies that States with a deficiency of the particular service which is assisted, *e.g.*, education or roads, would receive a proportionately greater measure of assistance than those which are relatively better served.

15. As regards the relative role of unconditional and conditional grants in the scheme of financial assistance by the federal authority, there is no clear lead in the experience of other federations, there being no single system of universal applicability in regard to this sector of federal financial relations. It appears that each country has tried to find for itself the system or combination of systems that best fits the facts of its political, economic and administrative conditions.

16. We believe that both the methods of conditional and unconditional grants should have their part to play in the scheme of assistance by the Centre. Unconditional grants should reinforce the general resources of the State Governments, which they would be free to

allocate among competing purposes according to their best judgment, subject to the usual administrative and parliamentary checks. Grants for broad purposes may be given to stimulate the expansion of particular categories of services rather than specified schemes under those categories. In the following paragraphs we consider the principles which should govern grants-in-aid to States.

#### PRINCIPLES RECOMMENDED

17. *Budgetary needs.*—As budgetary needs are an important criterion for determining the eligibility of a State for a grant-in-aid as well as for the assessment of the amount of the grant-in-aid, the budget has necessarily to be the starting point of an examination of fiscal need. In using the budget as a basis for this purpose, several adjustments are, however, necessary in the State budgets. These adjustments should, in the first place, reduce all budgets to a comparable basis. Adjustments are called for in respect of any abnormal or unusual and non-recurrent items of receipts or expenditure which may vitiate comparisons unless these are excluded. Besides such adjustments, which should be made for the purpose of arriving at what might be broadly termed a normal budget, certain other allowances mentioned below have also to be made.

18. *Tax effort.*—The extent of self-help of a State should determine the eligibility for, as well as the amount of, help from the Centre. This requires an assessment of the general scope for additional taxation in the States and of their tax effort. The point may be made that differences in relative taxation from State to State are of no relevance for the purpose of determining the degree of Central assistance to various States, as such assistance should be based primarily on the comparative poverty or affluence of the States, as judged by indices of their relative *per capita* incomes. This argument seems to miss the rationale of taking the relative tax effort of States into consideration. A State which is prepared to raise the maximum amount of revenue through taxation is better entitled to Central assistance than a State which does not itself act sufficiently in the same direction. In respect of a State in the latter class, there is no guarantee that the benefit of external assistance will, in fact, accrue to the weaker sections of the community for whom it would be intended. Assistance to such a State may have the effect of postponing action by the State to increase its own taxation. Such assistance from outside may thus go to relieve those who are comparatively well off from the necessity of contributing more to State revenues rather than help to increase public expenditure for the benefit of the general mass of the people. It may be observed that it is only in clear cases of inadequate taxation that this should affect the quantum of assistance a State would otherwise be qualified to get.



19. *Economy in expenditure.*—An allowance should be made for possibilities of economy in expenditure. *The principle of self-help also implies that a State should utilise its existing resources to good account before it makes a claim for assistance from the Centre.* We should like to emphasise here that it is not the purpose of any system of grants-in-aid to diminish the responsibility of the State Governments to balance their own budgets. The method of extending financial assistance should be such as to avoid any suggestion that the Central Government have taken upon themselves the responsibility for helping the States to balance their budgets from year to year. If the amount of grants-in-aid were to be merely in proportion to the financial plight of a State, a direct premium might be placed on impecunious policies and a penalty imposed on financial prudence. On the other hand, if a State is eligible for a grant on other grounds, it should not be precluded from this benefit, merely because its budget is in order as a result of its sound financial management.

20. *Standard of social services.*—An important purpose of grants-in-aid is to help in equalising standards of basic social services. The standards of social services in a State may be a criterion for grant-in-aid. Thus, of two States whose budgets, with the adjustments already indicated, point to the need for an equal amount of assistance, the one with a significantly lower level of social services should, in our view, qualify for a higher amount of assistance than the other with a relatively high level of such services. Alternatively, in marginal cases, a State with a high level of such services may become ineligible, while another State with a low level of services is eligible for a grant. Factors like the area of a State in relation to its population, economic backwardness, etc., would be reflected in the level of social services and the standard of development of a State, and would be taken into account accordingly under this principle.

21. *Special obligations.*—Grants-in-aid may be given to help a State to meet special burdens or obligations of national concern, though within the State sphere, if they involve an undue strain on its finances. Certain States may have special obligations or burdens likely to continue for a period of years, i.e., commitments arising out of abnormal conditions. These would justify assistance by way of grants-in-aid to the States concerned. The circumstances necessitating assistance may, for example, include the consequences of partition, such as the disruption of the institutional framework of a State, the strain on the economy and administration of a State, and its increased responsibility in respect of security.

22. *Broad purposes of national importance.*—Independently of the budgetary criterion, grants may be given to further any beneficent service of primary importance in regard to which it is in

the national interest to assist the less advanced States to go forward. It is, in our view, desirable to provide grants-in-aid for a broad purpose, selected with reference both to the importance of the service assisted and to the practicability of measuring, from time to time, the standard of the service on the basis of reliable indices.

23. We have ourselves applied the above principles, as far as possible, in the determination of the States in need of assistance as well as of the amounts of grants-in-aid which we recommend for the various States. As information regarding the finances of State Governments and other relevant matters comes to be better organised, it may be possible to make a more precise application of the principles.

## CHAPTER VIII

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### GRANTS-IN-AID TO STATES

*Constitutional provisions.*—We have been directed by the President to make recommendations in regard to the States which may be in need of assistance and the sums to be paid to such States as grants-in-aid of their revenues, under the substantive portion of clause (1) of Article 275 of the Constitution.

2. *Some broad considerations.*—In assessing the needs of the States and formulating our recommendations in regard to the sums to be paid as grants-in-aid we have considered the budgetary position of the States and the probable amount which would accrue to them under our plan for the devolution of revenue from income-tax and Union excises, which we have explained in the earlier chapters of the Report. We have taken into account the additional burdens arising out of the partition of the country which have been placed upon some of the States. We have also kept before us the need for assisting to some extent, the less developed States by the provision of special grants which would enable them to raise the standards of one of the important social services. While it has not been possible for us to meet all the demands placed before us by the State Governments for assistance by way of grants, as a result of our scheme most States will receive, by the devolution of revenue and Central grants, more resources than they received in the past.

3. *Claims by States.*—We received from the State Governments forecasts of the revenue and expenditure for the five years beginning with 1952-53. These were based on the existing levels of taxation and expenditure and were of considerable assistance to us in taking a view of their financial position. In addition to requests for assistance on the basis of budgetary needs most States also preferred a number of specific claims for assistance. These latter covered a wide field and among the more important we would mention claims for assistance for financing the Five-Year Plan and carrying out schemes not included in it; meeting the burdens in regard to the maintenance of security as a result of the partition and the subsequent developments; covering the recurring loss on the maintenance of certain minor ports; meeting expenditure on the reorganisation of pay structures in certain States as a result of the integration or merger of the former Indian States, and levelling up of administration in the "merged areas."

4. So far as the claims relate to finance required for schemes of capital outlay, these are hardly likely to be met by grants from revenue with which we are primarily concerned. Nor are we concerned with the provision of finance for the various individual schemes included in the Five-Year Plan taken by themselves. In so far as they involve expenditure on revenue account this will have to be met from the revenues, as augmented by the States' efforts or by our scheme.

5. As regards the other requests for grants which relate to expenditure normally met out of the revenue budget, we have given them our careful consideration and taken them into account in assessing the needs of the individual States. Some of the factors, such as the effects of "mergers", given as the ground for the claims are already reflected in the expenditure budgets of the States which we have taken into account. For the rest, these demands will have to be financed from the future budgets of these States to the extent to which their finances permit. In our view, so long as the claim relates to a subject which is constitutionally the responsibility of a State Government, it can arise ordinarily only as part of the total financial commitments of the State as a whole. Lastly, for reasons explained in an earlier chapter we have not gone into the complaints made by some of the Part B States against the fixation of the "revenue gap grants".

6. The Government of Travancore-Cochin asked for the continuance of the grant of Rs. 3 crores promised to them in the current year to meet the expenditure on subsidising food in the State. This grant is now presumably being made under Article 282 of the Constitution with which we are not required to deal. In any case, the question of giving a subsidy in the future will have to be considered from time to time with reference to changes in policy in regard to imports and internal procurement, the then ruling prices and the price level which the State Government may be required by the Centre to maintain. It is not, therefore, possible to take any view on this problematic matter but we merely mention it because of the importance attached to this point by the State Government. We should not, thereby, be considered as having expressed any opinion on the merits of the claim.

7. *Revenue and expenditure of States.*—Appendix VIII summarises for each State its revenue and expenditure in the last three years and the estimated position in the current year, excluding from its revenue the share of income-tax and the statutory grants from the Centre.

8. *Claims examined.*—Under our scheme for the devolution of revenue all the States except Bombay, Punjab, Mysore, Travancore-Cochin and Saurashtra are likely to receive a larger measure of