

CHAPTER 9

PRINCIPLES GOVERNING GRANTS-IN-AID OF REVENUES

97. Article 280(3) (b) of the Constitution requires us to make recommendations as to the principles which should govern the grants-in-aid of the revenues of the States out of the Consolidated Fund of India.

98. The First Finance Commission considered the matter in detail and recommended that budgetary needs of the States should be an important criterion for determining the assistance required by the States, but that in arriving at the needs, appropriate allowances have to be made based on a number of considerations. The first consideration was that the budgets should be reduced to a standard form by eliminating non-repetitive items. Second, due consideration should be given to the tax effort by the State and the extent to which the State itself had made efforts to raise resources in relation to its tax potential. Third, allowance should be made for the scope for economy in expenditure. Fourth, the system of grants-in-aid should be designed to avoid large disparities in the standards of basic social services. Fifth, grants-in-aid may be given to help individual States to meet their special burdens, if such burdens are of national concern and if they are likely to cause undue strain on the States' finances. Sixth, grants-in-aid may be given for broad national purposes with a view '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'.

99. The Second Finance Commission considered these principles unexceptionable. It, however, added that the eligibility of a State to grants-in-aid and the quantum of such aid should depend upon its fiscal need in a comprehensive sense. That Commission also felt that the gap between the ordinary revenue of a State and its normal revenue expenditure should as far as possible be met by sharing of taxes and that grants-in-aid should be the residuary form of assistance. Although it recognised that specific purpose grants may be given, no such grants were given by that Commission.

100. The Third Finance Commission also was in agreement with the general principles enunciated by the earlier Commissions. It, however, felt that the 'fiscal needs' as assessed by the Commission should take into account not only non-plan expenditure but also

plan expenditure; it also felt that it would be advisable to attach strict conditions of utilisation to any grants-in-aid given for activities meant to serve national purposes but that States should have freedom to reappropriate funds from one allocation to another in respect of grants meant generally to strengthen the State sector.

101. The above principles laid down by the previous Commissions are still valid and we agree with them except to the extent that we do not recommend the inclusion of plan grants and special purpose grants in grants-in-aid, for reasons which are given elsewhere in this report. In applying these principles and working out the grants-in-aid admissible to States, our terms of reference require us to have due regard to certain special considerations which were not specifically mentioned in the terms of reference to the earlier Commissions. Among these considerations are the expenditure devolving on the States for servicing of their debt, the creation of a fund out of part of the proceeds of estate duty, and the scope for economy consistent with efficiency which may be effected by the States in their administrative expenditure. We have dealt with some of these considerations in other parts of this Report. The procedure followed by us to work out the fiscal needs of the States is also discussed in the following chapter in connection with the determination of the quantum of the grants-in-aid under article 275(1) of the Constitution.