

## CHAPTER 6

### GRANTS-IN-AID UNDER ARTICLE 275 OF THE CONSTITUTION

6.1 Under item (b) of paragraph 4 of the President's Order dated the 29th February, 1968, we are required 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 and also to recommend the sums to be paid to the States which are in need of assistance by way of grants-in-aid of their revenues under Article 275 for purposes other than the Five Year Plans, having regard, among other considerations, to—

- (i) the revenue resources of those States for the five years ending with the financial year 1973-74 on the basis of the levels of taxation likely to be reached at the end of the financial year 1968-69;
- (ii) the requirements on revenue account of those States to meet the expenditure on administration, interest charges in respect of their debt, maintenance and upkeep of Plan schemes completed by the end of 1968-69, transfer of funds to local bodies and aided institutions and other committed expenditure; and
- (iii) the scope for better fiscal management as also for economy consistent with efficiency which may be effected by the States in their administrative, maintenance, developmental and other expenditure.

6.2 The earlier Finance Commissions have broadly agreed that while the budgetary needs of the States are an important factor in determining the assistance required by the States, a number of adjustments have to be made and several broad considerations kept in mind to determine the amounts of assistance which the States need as grants under Article 275. Their budgetary forecasts have first to be suitably modified to a standard form so as to make them comparable. It is necessary to take into account the efforts made by them to raise resources in relation to their tax potential and the scope for economy in expenditure, and to have regard to the need to avoid large disparities in the standards of basic social services and to provide for special burdens of national interest likely to prove financially strenuous to States. These principles have been generally recognised as unexceptionable. The main differences have been the approach of the different Commissions to grants for Plan purposes and earmarked grants for broad national purposes like education.

6.3 In Chapter 2, we have already explained that it is not possible for us to take into account any requirements for the Five Year Plan. It has been suggested to us that we should follow the procedure of the First Finance Commission and earmark a portion of the

grant for the purpose of raising school teachers' salaries to a minimum level. We think, however, that it would be difficult for us as a Commission to judge the requirements for improving the efficiency of existing services through better terms of remuneration. We understand that for the purpose of Plan assistance, the Planning Commission has also been thinking of shifting the emphasis from grants for specific purposes towards block grants for Plan expenditure generally. The Fourth Finance Commission had observed in this connection that even if a special grant could be made under Article 275, such a grant would get merged with the general revenues of the States. Its utilisation could only be reviewed by a subsequent Finance Commission and this would not be of any practical value. We agree with this view.

6.4 While the Finance Commissions have broadly agreed on the principles which should govern the determination of the States' need for assistance, there have been differences in the extent to which they have been able to take these into account. As regards assessment of tax effort, the Second Finance Commission stated—

“In our assessment of tax effort we have assumed that if a State raised additional revenue which it has promised for the Plan, it will have done its part”.\*

The Third Finance Commission did not take tax effort into account as it felt that the comparative determination of the tax effort of the States had to be related to their tax potential and required special study. The Fourth Finance Commission expressed agreement with the principle of considering how far the States had made efforts to raise resources in relation to their tax potential. However, in its assessment of the States' needs, it took into account only non-Plan revenue expenditure and the revenue receipts anticipated on the basis of the then existing level of taxes, and did not examine the extent of additional tax effort as it was related to the financing of the States' Plan expenditure. It left out of account the estimated losses by departmentally managed enterprises and assumed full realisation of current interest dues from autonomous corporations like the State Electricity Boards.

6.5 In view of the rapid growth of State expenditure and the very large size of budgetary deficits which, as indicated in the States' forecasts, comes to Rs. 7,368 crores, we consider that the emphasis must shift significantly from budgetary needs to broad fiscal needs as suggested by the Second Finance Commission. We have accordingly tried to apply the principles laid down by the previous Commissions more extensively. For the purpose of assessing the needs of each State for meeting revenue expenditure, the States' forecasts were duly scrutinised with a view to placing them on a comparable footing as well as correcting errors of estimation. The receipts and working expenses in respect of the various departmental commercial schemes were segregated to facilitate separate examination of such schemes. Receipts of interest and dividends as well as payment of interest and provision for repayment or amortisation of debt were also separately

\*Report of the Finance Commission, 1967, para 64.

dealt with. For important items of tax receipts and of expenditure we adopted growth rates within suitable maximum and minimum limits on the basis of past trends, future scope and other relevant factors as explained by the States. The preliminary actuals of 1968-69, wherever available, and budget estimates for 1969-70, were also utilised in assessing the forecasts relating to the initial year 1969-70.

6.6 In our assessment of revenue receipts we have taken credit for the interest due from Electricity Boards, except in the case of Assam and Rajasthan. In these two States, we found that the cost of generation and distribution was abnormally high due to factors over which the State Governments had little control. The increased cost could not be covered by the revenue realised despite relatively high tariffs. We have, therefore, assumed in their case receipt of interest only to the extent of half the amount due. To the extent that the estimates of working of certain Electricity Boards during the five years reflected a net surplus, we have also assumed recovery of arrears of interest payments due from them; but we left out of account the portion of such arrears which had resulted from non-payment of interest in respect of the years 1966-67 to 1968-69, as the Fourth Finance Commission had assumed full payment of interest falling due from 1966-67 in assessing the budgetary needs of the States. In regard to recovery of interest of loans and advances by States to other parties, we assumed that each State Government would realise interest on such loans and advances; at least at the average rate of interest payable on its own borrowings. No increase over the forecast of recovery of interest has, however, been assumed in respect of rehabilitation loans given by the State Governments.

6.7 The material furnished by State Governments showed large amounts of arrears of tax revenues, particularly land revenue and sales taxes. In our assessment we have assumed that where these arrears exceed a moderate level representing normal arrears, the excess over such level would be realised during the Fourth Plan period.

6.8 Some State Governments indicated to us their intention to introduce prohibition by gradual stages, which would result in larger budgetary gaps on account of loss of excise revenue as well as additional expenditure required for enforcement staff. Some of them had assumed the receipt of grants from the Government of India for this purpose, on the basis of a communication from the then Deputy Prime Minister and Finance Minister offering to reimburse one-half of the loss of revenue suffered by the States on this account for a period of five years. We have taken the view that, while the State Governments have to decide their own policy regarding adoption of prohibition at such time and by such stages as they may consider desirable, the loss of revenue as well as the additional burden of expenditure required to be incurred on account of such policy should, at the same time, be made good by the States by raising further amounts from the resources available to them and adopting suitable measures of economy, with such assistance as the Government of India may be prepared to give to them. The grant of such assistance would be a matter for settlement between the concerned State Government and the Government of India, when the occasion arises.

Accordingly, in our assessment of the State Governments' forecasts, we have assumed the continuance of receipts from excise duties and expenditure on administration of State Excise Departments having regard to the position existing at the end of the year 1968-69.

6.9 On the expenditure side some of the States had provided for large transfers to certain Funds like State Road Funds. To the extent that the transfers to the Funds were utilised either for capital expenditure or for Plan expenditure, they have not been taken into account. Generally, we have also not included in our assessment any net accretions to these Funds.

6.10 We have taken into account the provision made in the States forecasts for repayment of zamindari abolition bonds or similar compensation bonds, except where, as in the case of Tamil Nadu, the arrangement was intended to be self-financing and the entire cost of compensation was to be recovered from the allottees over a period of time.

6.11 We did not take into account losses in the case of road transport schemes, in the expectation that the State Governments will take effective measures to obtain returns from them which would cover the working expenses, depreciation and interest.

6.12 A number of States included in their forecasts large amounts for expenditure on maintenance and repairs of roads and buildings and irrigation works. It was represented that on account of paucity of funds they had not been able to maintain their assets properly in the past, and that it was necessary to provide for clearance of the backlog of repairs as well as for maintenance on improved standards. Some State Governments gave us detailed estimates indicating the levels of expenditure considered necessary for such improved maintenance. The Ministry of Transport and Shipping also furnished us with estimates of normal costs of proper maintenance of certain categories of roads by regions as worked out by a Committee of technical officers. The provisions suggested in these estimates could not be put on a comparable basis and we did not find it practicable to adopt a general standard for such expenditure which could be uniformly applied. However, in our assessment we recognised the need for better maintenance and included provision on the basis of average expenditure during the last three years with substantial increase thereon. Similar increase was also made in the case of capital expenditure on public works and irrigation met from revenue.

6.13 Many States included in their forecasts their requirements of expenditure for increases in dearness allowance and revision of pay scales for which they had already incurred liabilities in most cases. So far as dearness allowance is concerned, it was urged that the periodical decisions of the Government of India to increase the dearness allowance of their employees left the State Governments with little option but to allow similar increases for their own employees. In some States the pay scales have also been revised recently, whereas a general revision of the scales of pay of Central Government employees has not been undertaken since 1959, and in such cases we did not think that parity of rates of dearness allowance

could justifiably be claimed with those applicable to Central Government employees. We did not find it possible to adjust the requirements on this account owing to lack of detailed information. We have therefore taken into account the likely expenditure on dearness allowance in full. We have not, however, provided for increases of dearness allowance in future. In regard to pay revisions, some State Governments had already given effect to their decisions before the end of 1968-69; others took decisions during the current year, whereas in some cases the States indicated the anticipated effect of pay revisions on the basis of reports of their Pay Commissions, or the likely recommendations of the Commissions whose reports were still awaited. We consider that in cases where the level of expenditure of a State Government is already high, it is necessary to exercise greater restraint in undertaking additional liabilities such as those resulting from pay revision, unless additional resources to meet them can be found by the State Government's own efforts. At the same time, we felt that the recommendations of such Pay Commissions would generally have to be implemented by the State Governments, and for the purpose of our assessment we have included the provisions necessary for this purpose.

6.14 We have allowed provision for payment of food subsidies which are at present being given, but we have not included any provision for enlargement of their scope or for fresh expenditure on such schemes. On the same principle, we have also allowed in our assessments subsidies to State Electricity Boards on account of rural electrification wherever included by the State Governments in their forecasts.

6.15 The earlier Finance Commissions took into account the likely expenditure on relief measures necessitated by natural calamities like famine, floods, etc. The Fourth Finance Commission reassessed the amounts required for this item on the basis of figures of gross expenditure for the eight years ending with 1964-65. We noted that expenditure on this account in the years 1966-67 and 1967-68 during which large parts of the country suffered from severe drought, was clearly abnormal. We, therefore, reassessed the amounts likely to be required for this item on the basis of the average expenditure for the nine years 1957-58 to 1965-66, increased by 25 per cent. in each case. The provision allowed by the Fourth Finance Commission was, however, retained if it was higher than the figures worked out on this basis. In the case of Punjab and Haryana, the requirement was worked out in respect of the former Punjab State on the same principle, and the shares of the two States were determined in the proportion in which the non-Plan expenditure under head "64—Famine Relief" had been allocated by the Dehejia Committee on the division of assets and liabilities of Punjab, in consequence of the Punjab Reorganisation Act, 1966. The Fourth Finance Commission has mentioned in its Report that the provision allowed in the case of West Bengal was strictly comparable with that of other States, as the expenditure in this State under the head "64—Famine Relief" included some expenditure which was not normally included under this head in other States. We have, therefore, determined the requirement on the basis of the provision allowed for the neighbouring

State of Orissa, on a *per capita* basis. The difference between the amount so arrived at and the annual provision made for this purpose by the Fourth Finance Commission for West Bengal, has been added to the estimate of the State's expenditure under the head "Miscellaneous" for calculating its revenue deficit.

6.16 The annual average provisions allowed by us in the States' forecasts on the basis explained above are indicated below:—

State	Annual provision allowed for relief from natural cala- mities (Rs. lakhs)
Andhra Pradesh . . . . .	75
Assam . . . . .	48
Bihar . . . . .	150
Gujarat . . . . .	80
Haryana . . . . .	155
Jammu & Kashmir . . . . .	40
Kerala . . . . .	10
Madhya Pradesh . . . . .	80
Maharashtra . . . . .	86
Mysore . . . . .	44
Nagaland . . . . .	..
Orissa . . . . .	125
Punjab . . . . .	41
Rajasthan . . . . .	108
Tamil Nadu . . . . .	50
Uttar Pradesh . . . . .	94
West Bengal . . . . .	261
<b>TOTAL . . . . .</b>	<b>1447</b>

6.17 While continuing the practice of making a separate annual provision for expenditure under Famine Relief, we consider that the excess of such provision over the actual expenditure on famine relief in each year should be transferred to a separate Famine Relief Fund which may be drawn upon in other years for meeting expenditure required in excess of the provision allowed by us. We also suggest that the amount of appropriations to the Famine Relief Fund should be invested in easily realisable securities. Although an exactly similar recommendation was made by earlier Finance Commissions also

the State Governments have not apparently been able to implement it. If this position continues and the annual appropriations are used to relieve the current ways and means position of the State, the provision allowed by us for famine relief and natural calamities would not serve its real purpose. We, therefore, hope that the State Governments will be able to take appropriate action to implement our recommendation in this respect. Further, in determining the assistance to be given by the Government of India under their scheme of assistance to States for expenditure on relief measures, we think that the accumulated provision for the entire period from 1969-70, and not merely the annual provision relating to the year in which the natural calamity occurs, should be taken into account. Further, it seems to us that for meeting expenditure on natural calamities it would be more fitting if the 75 per cent. assistance to the States, whose finances would also have been adversely affected on the receipts side, is given wholly in the form of grants; and only the amount required for State loans to others may be covered by Central loans. The remaining burden of famine relief expenditure should be met by the State itself, as it will be the primary authority for deciding the level of famine expenditure. As at present, a ways and means loan may be given to the States, where necessary, to meet temporary difficulties.

6.18 Separate estimates were furnished by the States in regard to the requirements of expenditure on the maintenance and upkeep of Plan schemes completed by the end of 1968-69. These estimates were scrutinised with reference to the schemewise break-up of the revenue Plan outlays during 1968-69. Generally speaking, we did not take into account provision for contingent expenditure of a non-recurring nature, minor works, or grants for purposes of a capital nature. Expenditure on Establishment and contingencies was generally allowed. Provision for maintenance of roads, buildings, etc., was allowed on the same basis as for similar non-Plan expenditure. The rates of growth adopted in estimating the recurring committed expenditure over the five-year period were limited to the rates adopted in assessing corresponding items of revenue expenditure. In cases where such schemewise scrutiny was not possible due to inadequate data and the provision in the State's forecast worked out to a higher percentage of the revenue Plan outlay for 1968-69 than the percentage of the committed expenditure in 1966-67 to the revenue Plan outlay in 1965-66, the provision was limited to the latter percentage after increasing it by 10 per cent. thereof, in order to cover possible variations in the pattern of completed Plan schemes.

6.19 For the purpose of estimating the sums likely to accrue to the States under our recommendations for devolution of taxes, we have adopted the estimates of taxes and duties furnished to us by the Ministry of Finance. We have taken into account the grant in lieu of the tax on railway passenger fares at its present level of Rs. 16.25 crores a year. In case the present arrangements regarding additional excise duties are discontinued, we have assumed that the States will continue to get at least the same amounts from sales tax on these commodities as their share of the proceeds of additional excise duties. Unlike the previous Finance Commissions, this Commission has had

to deal with the problem of distribution of unadjusted advance tax collections for the years upto 1966-67, and the increased net proceeds of income-tax determined on the revised basis for the years 1967-68 and 1968-69. We have assumed that final payment to the States for the year 1967-68 will be made in 1969-70 when the net proceeds are certified by the Comptroller and Auditor General, and that similar payment for the year 1968-69 will be made in 1970-71. We have recommended that the States' share of the unadjusted advance tax collections upto 1966-67 should be paid to them in three equal instalments during the years 1971-72 to 1973-74. The total sums expected to be transferred to States by devolution of taxes in the five years have been estimated on this basis. The total amount of such devolution of taxes to all the States, including the grant in lieu of tax on railway passenger fares and proceeds of additional excise duties comes to about 66 per cent. more than the amount of such devolution as recommended by the Fourth Finance Commission in its report for the five-year period from 1966-67 to 1970-71.

6.20 Some States have argued that the increased devolution due to the inclusion of advance tax collections of past years should not be taken into account in estimating their resources over the next five years as they should have been paid larger shares of income-tax proceeds in the earlier years when the collections were made. They have represented that the delay has already added to their financial difficulties and left them with greater loan liabilities. Though we appreciate the States' argument in this regard, particularly in view of the higher expenditure on dearness allowance, etc., which they have had to incur, we cannot agree with their contention that the increase in devolution which they will receive on this account in the next five years should not be included in their revenue resources for assessing their needs for grants. The share of the divisible pool which the States should receive has not been laid down in any specific terms under the Constitution, but it is to be determined for each period on the basis of the recommendations of the Finance Commission appointed under Article 280 of the Constitution. It is clear that the earlier Finance Commissions had before them the estimates of proceeds of income-tax worked out by the Government of India on the basis that advance tax collections were to be included in the proceeds only after completion of assessments. The recommendations of these Commissions for distribution of income-tax as well as other devolution of taxes and grants under Article 275 were based on these estimates and also on their overall view regarding the total transfers which were necessary to meet the requirements of States as assessed by them. It is not possible for anyone to form an opinion as to what the earlier Commissions would have done in the matter of devolutions if the estimates of proceeds of income-tax before them had included advance tax collections. But the procedure followed by them makes it clear that at least the grants under Article 275 recommended by them might have been smaller. We consider that the States cannot claim as of right that their share of the unforeseen increase in the divisible proceeds of past years which has resulted from the modification in the method of determining the net proceeds of income-tax should be paid to them without being taken into account for the purpose of the whole scheme of transfer of funds to them on assessment of their needs for the next



five years. The supplementary reference made to us also specifically requires us to take into account the effect of our recommendations regarding the matters specified therein, in making our recommendations for other devolutions and grants. We have accordingly treated the States' shares of the unadjusted amount of advance tax and balance of income-tax proceeds of earlier years as part of the resources available to them for meeting their revenue expenditure in the five-year period.

6.21 On the basis of the estimated devolution of taxes to each State worked out as above and assessment of the States' forecasts of their revenue receipts and expenditure as indicated earlier, we found that the States of Bihar, Gujarat, Haryana, Madhya Pradesh, Maharashtra, Mysore, Punjab and Uttar Pradesh will be receiving by devolution of taxes amounts which will be sufficient to cover their non-Plan revenue expenditure in the next five years as assessed by us.

6.22 The requirements of the other States for grants under Article 275 were then examined in greater detail. As regards their revenue receipts, we have, according to our terms of reference, taken into consideration the scope for better fiscal management. We also kept in mind the principle approved by the earlier Finance Commissions that the efforts made by the States to raise resources in relation to their tax potential should be taken into account. We made a broad comparison of each State's total tax revenue at the existing levels of taxation with that of other States on a *per capita* basis. We excluded the receipts from inter-State sales tax in making this comparison. Taking the basis of average State incomes for the three years 1962-63 to 1964-65 furnished to us by the Central Statistical Organisation, we also compared the tax effort as indicated by taking the total tax revenues as a percentage of the State income, after making some allowance for lower yields from agricultural income. We felt that owing to the different circumstances of each State and different policies of the State Governments and the lack of satisfactory data regarding the bases of different State taxes, it was not possible to compare the incidence or yields of particular taxes levied by the States. We therefore considered that a broad comparison should be made on the basis of the incidence of total State taxes in the context of the tax potential of each State as indicated by its level of *per capita* income. In coming to a view regarding the tax effort of a State where the incidence of total State taxes was low, however, we took note of the relative rates of comparable taxes to the extent possible. In cases where the tax effort of the State examined in this manner appeared to be considerably lower than that of other States with similar *per capita* income, and particularly States with similar conditions of development, we took this factor into account in assessing the extent to which the State could be expected to make efforts to raise its resources so as to bring it to a comparable level, unless we found that the level of expenditure of the State as compared to similar States was also appreciably lower.

6.23 As regards non-tax revenues, we felt that it was not possible to compare the receipts from mining royalties and net receipts from forests. No adjustment for these receipts was considered necessary.

Receipts from interest on loans and dividends on investments as well as receipts from departmental commercial schemes were separated for being considered on a different footing. The balance of other non-tax revenues was not examined directly, but we took it into account in reduction of the State's revenue expenditure on normal items (excluding interest and other debt charges; expenditure on departmental commercial schemes and provision for famine relief), and we compared such net expenditure with similar expenditure of other States having the same order of *per capita* income and economic development on the lines indicated in paragraph 6.26 below. We shall consider the question of interest receipts, dividends and receipts from departmental commercial schemes along with the interest payments and expenditure on departmental commercial schemes respectively in subsequent paragraphs.

6.24 We examined the revenue expenditure of the States as assessed by us according to broad categories. We separated the provisions for interest, appropriation for reduction of debt and expenditure on departmental commercial schemes which are not of a comparable nature. We have considered these along with the corresponding receipts under paragraph 6.33. We also excluded provision for famine relief, which has been dealt with in paragraphs 6.15 and 6.16 above. The remaining expenditure including provision for dearness allowance, pay revision, committed expenditure and proposals for fresh expenditure included in the forecasts was taken as the State's normal revenue expenditure for the purpose of comparison with the level of expenditure in other States.

6.25 The terms of reference require us to have regard to the scope for economy consistent with efficiency. We collected from the States information regarding the economy measures undertaken by them. They gave us details of the steps they had taken in this direction from 1965-66 to 1967-68, including directives to keep vacancies unfillied, curtailment of contingent and travelling expenditure, reduction of provision for maintenance of public works, etc. Several States, however, urged that by their very nature such measures could only be of a short duration and that if they were to continue for a long time they were likely to have an adverse effect on efficiency. They, therefore, proposed to relax most of these restrictions. It was not feasible for us to undertake any examination of the requirements of various State Departments and judge the possibilities of effecting economy. We have, therefore, examined the total revenue expenditure (after excluding famine relief, losses on departmental commercial schemes and net burden of interest) on broad considerations in the light of the levels of such expenditure in other States, particularly those with similar *per capita* income and having similar conditions.

6.26 As the expenditure levels of different States in respect of particular departments and services differ considerably on account of their individual circumstances and policies and the growth of various State activities in the past, it was not possible for us to compare the levels of expenditure in different States in particular fields. We considered that a broad comparison of the levels of total revenue expenditure (after excluding the items mentioned above) would be suitable

for assessing the relative needs of States on an equitable basis, particularly as between States with similar levels of income and similar conditions, but with large variations in regard to levels of expenditure. We also took into consideration certain special features of some of the States which tend to increase the level of their revenue expenditure, such as border areas, proportion of Scheduled Tribes, sparseness of population and higher level of development of social services. These are dealt with further in paragraphs 6.27 to 6.32, below. After making some allowance for such factors, we considered that where the level of expenditure in a State was substantially higher than that generally indicated by expenditure in other comparable States, it should be the State's responsibility to find further resources for meeting part of the extra expenditure and the budgetary deficit as assessed by us should not be covered entirely by grants under Article 275 unless we found that the tax effort of the State in relation to its *per capita* income was also substantially higher than that of States with similar *per capita* income and comparable conditions.

6.27 Several States asked us to consider allowing them a higher level of revenue expenditure on account of certain special factors. These factors are mainly problems of border areas, refugee rehabilitation, large proportion of Scheduled Tribes and sparseness of population. As far as border problems are concerned, many of them are being looked after by the Union which has the responsibility of guarding the frontiers of the country and maintaining the necessary armed and other forces. Border roads of strategic value are constructed entirely from the funds of the Government of India and special grants are also given to State Governments for their maintenance. In addition, the Government of India give special grants for development of border areas. Nevertheless, the States on the border, especially those adjoining Pakistan and China, have to incur some extra expenditure for guarding against infiltration and sabotage and for seeing that the people in the border areas are assisted in their problems. We have kept this factor in view in assessing the level of expenditure of such States.

6.28 In this connection, we may mention that the Government of Jammu and Kashmir had proposed a special provision of Rs. 920 crores for strengthening and re-organisation of police along the border. These requirements are largely related to the existence of a long cease-fire line with Pakistan and the security problems arising therefrom. We took the view that where such problems exist, it should be left to the Government of India to determine the quantum of further assistance for such purposes in the light of circumstances existing from time to time. Another special liability of border States for which some of them suggested provision, is on account of maintenance of border roads. The responsibility of maintenance of border roads of strategic value built by or at the instance of the Central Government is at present that of the Government of India. We took the view that maintenance of other State Roads in border areas was the normal responsibility of the State Government concerned and no special grant can be provided for this purpose as requested by one State.

6.29 As regards relief and rehabilitation of displaced persons, the Government of India are making provision for this purpose in their budget and they also give grants and loans to States. Such loans are repaid only to the extent that the State Governments can recover them. We, therefore, did not see any reason for making a special provision on this account.

6.30 As far as Scheduled Tribes are concerned, the first proviso to Article 275(1) of the Constitution contains a special provision regarding grants for schemes to promote their welfare, and substantial amounts are being disbursed to States under this provision. Special loans are also being given to States for the welfare of Scheduled Tribes. Besides, the Planning Commission makes special provision both in State Plans and under Centrally sponsored schemes for their social and economic development. However, in view of the economy of the Scheduled Tribes being largely a non-monetized economy and their taxable capacity being lower than that of other sections of the people, we have included the proportion of Scheduled Tribes population in the weightage given to backwardness in our scheme for distribution of Union excise duties. We have also kept this factor in view while considering the comparative levels of expenditure in various States.

6.31 Some sparsely populated States represented to us that their costs of administration and level of expenditure for maintaining an efficient level of social services are high because of their relatively larger area. In some cases, though their actual expenditure is not high, that is due to their lack of resources and low level of services which they are able to provide. We consider this factor is relevant for assessing the level of expenditure and we have kept it in mind.

6.32 We found that more developed economic and social services were one of the important reasons for the higher revenue expenditure in some States. These services have been developed upto different levels mainly due to historical reasons and different policies regarding expenditure on Plan schemes relating to education and other social services. Any contraction of such services is not desirable. The States where such expenditure is high and which are in need of grants under Article 275 cannot be expected to raise entirely by their own efforts the additional resources for meeting the increased costs for a number of years. We have therefore allowed in case of such States a substantially higher level of expenditure as compared to other States.

6.33 We now turn to the consideration of the net expenditure on account of interest charges and returns from departmental commercial schemes and other investments. As indicated in paragraph 6.6 above, we have, following the principle adopted by the Fourth Finance Commission, generally assumed that the full amount of interest due would be received by the States from their Electricity Boards. We also assumed recovery of interest on loans and advances to other parties at a rate equivalent to the average rate of interest payable by the State on its own borrowings. The bulk of the remaining part of the States' debt is accounted for by capital expenditure on

departmental schemes of irrigation, road transport etc., and by investments in other corporations, companies and industrial concerns. We have applied the principle similar to that adopted by the Fourth Finance Commission in case of these investments. We consider that in the case of multi-purpose river schemes (excluding the cost allocated to flood control) as well as irrigation (commercial), it should be possible for the States to take measures to increase their receipts so as to cover the working expenses on maintenance and management as well as interest on the capital outlay. Many agriculturists have been incurring higher costs in obtaining water from private sources, and there seems to be no reason why public sources of irrigation cannot be managed more satisfactorily so as to produce returns which can at least avoid loss. However, we have, for the present, assumed that within the next five years it would be possible for the State Governments to take steps to improve the returns for covering the working expenses and interest at the rate of  $2\frac{1}{2}$  per cent on the investment. As regards other departmental schemes and investments of State Governments, we have assumed that on the whole there would be no net loss and that these schemes and investments taken together will yield returns and dividends which would at least cover the interest charges on the capital involved.

6.34 The balance of the States' debt, which is not covered either by loans and advances or by outlay on commercial schemes or investments, is mainly represented by their capital expenditure on other works like roads, buildings, social services etc. In some cases, this debt is also partly due to miscellaneous development loans under the Plan, and *ad hoc* loans given by the Government of India to cover the unauthorised overdrafts of the State Governments. We have taken the view that the burden of interest charges related to *ad hoc* loans should not be taken into account for determining the need of the State for grant under Article 275, and it should be left to meet on its own the interest liability as well as repayment by making efforts to curtail its expenditure and augment its revenues. As regards the other debt, which is not covered by the State's loans to others or its investments and commercial schemes, it is clear that the States cannot meet the interest charges except from their general revenues. We found that the burden of such debt used for purposes not producing any direct returns varied greatly as between different States. We considered that it is desirable to keep the amount of such loans used for unproductive purposes within a suitable proportion of the States' own annual revenues. We have allowed interest on such debt after limiting its amount to 50 per cent of the States' own annual revenues as assessed by us. In the case of Assam, Jammu and Kashmir and Nagaland, such interest has been allowed on the whole amount of debt as well as their unfunded debt.

6.35 On the question of interest on fresh borrowings during the five-year period, we have adopted principles similar to those adopted for the existing debt at the end of 1968-69. The amount of such borrowings, or the purposes for which the moneys would be utilised, cannot be definitely estimated at this stage pending finalisation of the Five-Years Plan. The State Governments (excluding Jammu and Kashmir) have estimated the amount of such fresh loans to be taken by them at about Rs. 5,500 crores. It is certain that a large amount

of such loans will be in the form of Central assistance for the Plan, and some Central loans would also be given to the States for other purposes. We are of opinion that the use of loan funds should be restricted mainly to the requirement of loans and advances to be given by the States and for investment in their productive schemes which can in the long run earn enough to meet their interest charges at normal rates, in addition to working expenses and depreciation. Interest on such schemes during the time required for construction and a short gestation period thereafter, may have to be deferred or capitalised if the State cannot meet it from the surpluses of other schemes or its general revenues. But the returns in subsequent years should be expected to meet this additional liability of deferred or capitalised interest over a suitable period. In case of investments in schemes like irrigation which may not be able to pay the full interest charges for a considerable period, we consider that the terms of the loans should be suitably fixed by the Government of India having regard to the anticipated level of returns, and the interest may be waived or kept at a low rate during the period of construction as well as for a suitable period thereafter. The liability of interest in such cases could also be deferred for a suitable period if the State is unable to meet it from its other resources. We consider that in all such cases the burden of interest on the outlay need not be taken into account for the purpose of assessing the need of the State for a grant under Article 275.

6.36 Besides the loans used for schemes of revenue-yielding nature, which we have dealt with in the foregoing paragraph, the States also have to spend every year some amounts for capital expenditure on non-revenue yielding assets like roads, buildings, flood control works, etc. We are of the view that when such expenditure cannot be met from available revenue surpluses, it should be permissible to meet it from loans, and the interest payment for such loans should be included in the assessment of the revenue expenditure of the States. The amount of loans which the States will utilise for such purposes during the five-year period has not been settled and cannot be estimated properly but we have assumed a total amount of about Rs. 235 crores during the five years for such loans to be taken by all the States, and distributed it among them on the basis of population. We have allowed full interest on fresh borrowings to this extent.

6.37 In the past, a considerable part of the loans taken by States has been used for meeting revenue expenditure instead of creating assets, making investment in productive schemes or relending to other parties on suitable terms. Substantial amounts have thus been lent by the Government of India to the States in the form of Miscellaneous Development Loans. Even a part of the assistance given by the Government of India for meeting relief expenditure in case of famine and other natural calamities is in the form of loans. In recent years, several States have run into unauthorised overdrafts with the Reserve Bank of India, partly as a result of deficits in their revenue account. The Government of India have given *ad hoc* loans to the States for covering the unauthorised overdrafts. We consider that the use of loan funds for such purposes is not desirable in the interests of sound finance. We have therefore not made any provision for interest on any borrowings for such purposes.

6.38 We now turn to the question of provision for amortisation of the existing debt of the States as well as their likely borrowings in the five-year period. In this connection, we wish first to indicate the extent to which the total borrowings of States from the Central Government and other sources have increased during the recent years, as indicated below:

	(Rs. crores)			
	1955-56	1960-61	1965-66	1968-69
(A) Public debt at the close of the year				
Loans from Central Government . . . . .	876.07	2015.81	4100.92	5585.74
Others . . . . .	272.68	586.44	1149.11	1338.07
TOTAL . . . . .	<u>1148.75</u>	<u>2602.25</u>	<u>5250.03</u>	<u>6923.81</u>
(B) Unfunded debt . . . . .	83.19	134.93	194.82	305.07
Interest payments by States during the year . . . . .	322.98	86.73	207.20	339.08

6.39 The Second and Third Finance Commissions were of the view that it is not necessary to provide for amortisation of debts from revenue when such provision has to come out of devolution or grants under Article 275. The Fourth Finance Commission, however, took the view that the amortisation of market borrowing of the State Governments must form part of their revenue liabilities. It considered that the question of including provision for amortisation of loans in the revenue requirements of the States was not affected by the source from which the revenues of the State are derived, whether levied and collected by them or accruing to them by way of devolution of taxes or grants under Article 275. That Commission provided for amortisation of market borrowings of the State Governments to the extent of the provision made by them in accordance with their budgetary practices. The Government of India have recently extended to other States, which were not making such provision, the benefit of an equivalent amount for conversion of their Plan loans into grants, in order to remove the disparity between the States resulting from the procedure adopted by the Fourth Finance Commission.

6.40 The State Governments have in their forecasts submitted to us asked a total provision of Rs. 1,222 crores for amortisation of all their existing market loans as well a large part of their Central and other loans and also their fresh borrowings during the five-year period. The Chairman and one of our Members (Shri G. Swaminathan) are of the view that it would not be appropriate to allow any provision for the amortisation of debt as a liability on the revenue account of the States for the purpose of determining their need for

assistance under Article 275 of the Constitution. This is in accordance with the view expressed by the Second and the Third Finance Commissions. Their view is that the Centre should not be called upon to make an addition to the grants paid to the States to enable them to amortise from revenue any portion of their borrowings. States which have genuine revenue surpluses would, however, be free to make such provision for amortisation as they consider possible. Although the Fourth Finance Commission made a departure and allowed some amortisation provision in accordance with the then existing practices followed by the States, and the Government of India also granted further amounts to certain States where the provision taken into account by that Commission was inadequate, there is no reason why the Centre should give grants to States to enable them to repay their loans. It would be for the States themselves to raise adequate resources in order to meet amortisation charges and if this is not found practicable to repay their loans out of fresh borrowings. Apart from this, any scheme of amortisation confined to market loans will confer a greater benefit on the more advanced States which are in a better position to borrow from the open market.

6.41 It is no doubt desirable that such capital outlay as has been incurred on non-revenue-yielding assets should be written off to revenue over a suitable period of years, but the Finance Commission as such is not in a position to assess the extent to which the capital outlay should be treated as wholly unproductive. This examination should be entrusted to an expert Committee with which a representative of the Comptroller and Auditor-General of India should preferably be associated. It is desirable that such an examination is initiated by the Government of India as early as possible and suitable criteria laid down for future guidance. Pending such an examination the Chairman and Shri Swaminathan are of the view that it would be unnecessary to include any provision for amortisation in determining the grants-in-aid to be paid to the States. They are not in favour of the Commission themselves making a provision for amortisation or for writing off unproductive capital expenditure on an *ad hoc* basis, as this will not cover the entire amount of such expenditure and cannot solve the problem.

6.42 The remaining three Members of the Commission do not agree with the views expressed on this question by the Chairman and Shri Swaminathan. The view taken by these three members and their recommendations in this regard are as indicated in the following paragraphs.

6.43 After careful consideration of the views expressed on this question by the Second and Third Finance Commissions, they are of opinion that though the amounts of devolutions and grants under Article 275 are transferred to the States from the Union under relevant orders of the President or relevant legislation of Parliament, they are as much a part of their own resources as the revenue derived by them under their powers of taxation and from other sources available to them. The devolution of taxes and statutory grants has been incorporated in the Constitution as a part of the scheme of distribution of revenues between the Union and the States. They are, there-



fore, in agreement with the view taken by the Fourth Finance Commission that the question of provision for amortisation of loans is not affected by the sources from which the revenues of the States are derived, whether levied and collected by them or accruing to them by devolution of taxes or grants under Article 275. They consider, however, that the provision for amortisation should be more properly related to the purpose for which loan funds are utilised, rather than the source from which the loans have been obtained. Apart from the normal use of borrowed funds by States for making loans and advances to other parties and for capital outlay on departmental, commercial schemes and investment in corporations, Electricity Boards, etc., the States have also to find funds for their capital expenditure of non-revenue-yielding nature. They consider that when sufficient surpluses on revenue account are not available, there can be no objection to the use of borrowed funds for this purpose to a limited extent having regard to the annual revenues of the States. It is for this reason that the Commission has provided for interest on only a part of that portion of the existing debt which is not covered by loans and advances given by the State Governments and their productive capital expenditure and investments. On the same basis, the Commission has also provided for interest on a suitable amount of fresh borrowings in the next five years as explained in paragraph 6.36 above. They are, therefore, of opinion that provision should be made for amortisation, or repayment from revenue, of existing debt not covered by such revenue-yielding investments and loans, and of fresh borrowings utilised for such purpose. They have accordingly decided to include necessary provision for this purpose in assessing the revenue requirements of the States. In doing so, they have limited the amount of existing debt to be amortised to fifteen times the annual provision for the five-year period which the Commission has assumed for such loans and they have calculated the amounts required on the basis of amortisation over a period of 20 years in each case. They have also taken care to see that in cases where the total amount of productive investments and loans of a State is less than the amount of its Central debt (excluding *ad hoc* loans), the balance of the Central debt is also excluded from the remaining unproductive debt, so that the provision made by them should not involve the repayment or amortisation of any part of the Central debt of the States.

6.44 While they have made only a limited provision for the amortisation of loans used for non-revenue-yielding purposes, they wish to emphasise that it would be desirable for the States, in the interest of improving their finances, to make larger provision for amortisation of their loans to the maximum extent possible, having regard to their revenue position, and that the amounts so provided in their budgets should be either used for repayment of the loans or be earmarked and kept invested separately from their cash balances so that the moneys become available for meeting their liability for repayment in due course.

6.45 The amounts included as provision for amortisation or repayment of debt, including fresh borrowings in the five-year period, in

the assessment of the revenue requirements of the States in accordance with the view taken by the majority of the members of the Commission, are as given below:

*Provision for amortisation*

(Rs. crores)

State	Amount
Andhra Pradesh . . . . .	1.20
Assam . . . . .	3.34
Bihar . . . . .	12.02
Gujarat . . . . .	0.69
Haryana . . . . .	1.73
Jammu & Kashmir . . . . .	0.24
Kerala . . . . .	4.78
Madhya Pradesh . . . . .	9.12
Maharashtra . . . . .	1.32
Mysore . . . . .	0.78
Nagaland . . . . .	0.01
Orissa . . . . .	4.96
Punjab . . . . .	0.37
Rajasthan . . . . .	5.68
Tamil Nadu . . . . .	1.12
Uttar Pradesh . . . . .	2.45
West Bengal . . . . .	9.85
TOTAL . . . . .	<u>59.66</u>

These amounts are exclusive of the provision which have been made in the case of zamindari abolition bonds and the provision made in case of Rajasthan equal to the receipts from sale of lands mainly in the Rajasthan Canal Project for reducing the capital at charge.

6.46 Having expressed our separate views regarding the question of amortisation, we wish to indicate that we have, in assessing the revenue receipts and expenditure of the States and applying the principles and general conditions explained in the preceding paragraphs, particularly kept in view the special problems of the States of Assam, Jammu and Kashmir and Nagaland. We have tried to treat their needs and requirements with as much care and consideration as possible. The grants which we are recommending for these States are of a much larger magnitude than would ordinarily be justified in case of other States of similar size or having similar resources. We hope that these three States also will, on their part, make efforts to increase their resources and exercise better fiscal management and proper economy consistent with efficiency and take steps to improve the returns on their investments so that their financial position may steadily improve and in course of time they may be enabled to have more adequate revenues to improve their social and administrative services.

6.47 After assessing the forecasts of the revenue receipts and non-Plan revenue expenditure of the States and making suitable adjustments in accordance with the principles and general considerations explained in the foregoing paragraphs, we have come to the conclusion that States of Andhra Pradesh, Assam, Jammu and Kashmir, Kerala, Nagaland, Orissa, Rajasthan, Tamil Nadu and West Bengal will be requiring grants-in-aid under Article 275 of the Constitution. As we have modified the estimate of the States' requirements having regard to several considerations and assumptions, their existing budgetary requirements will not be covered by their own resources along with the devolutions of taxes and grants under Article 275 as worked out on this basis. As explained in paragraph 2.24, we consider that in such circumstances it is desirable for maintaining administrative and social services that the States should be given further assistance for some time during which they may be expected to take effective measures for improving their finances. We, therefore, consider it necessary to recommend larger sums as grants to these States for the earlier years and suitably reduced amounts during the subsequent years.

6.48 In the case of Mysore, the surplus after taking into account the amount of transfers comes to a nominal amount of Rs. 2.58 crores. The average amount of devolutions to this State during the five-year period would be less than the average annual amount of devolution of taxes and grants which it would have received on the basis of the recommendations of the Fourth Finance Commission. We consider it desirable that this State also should be given some further assistance on a diminishing basis, so as to allow the State sometime in which it can make suitable adjustments in its financial arrangements.

6.49 In accordance with the assessment of the States' revenue resources and their requirements on revenue account for non-Plan expenditure, including the provisions mentioned in paragraph 6.45 above, we find that, besides Mysore, the following States will, after the transfers to them by devolution of taxes as well as their share of the grant in lieu of tax on railway passenger fares and the proceeds of additional excise duties as recommended by us, having surpluses during the five-year period as indicated below. We do not, therefore, recommend any grant to the following States under Article 275:—

State	Surplus (Rs. crores)
Bihar . . . . .	199.46
Gujarat . . . . .	158.99
Haryana . . . . .	79.88
Madhya Pradesh . . . . .	15.09
Maharashtra . . . . .	419.29
Punjab . . . . .	117.22
Uttar Pradesh . . . . .	280.87
TOTAL . . . . .	<u>1270.80</u>

Of these States, Haryana, Maharashtra and Punjab had a revenue surplus according to our assessment, even without devolutions. The level of expenditure in Bihar and Uttar Pradesh was found to be low, and the deficits of these two States, as assessed by us, were much smaller than the devolutions which they will get on the basis of the principles adopted by us.

6.50 After making the assessments of the forecasts of revenue receipts and non-Plan revenue expenditure of the States as indicated in paragraph 6.47, and taking into account the provisions mentioned in paragraph 6.45 to the inclusion of which the Chairman and Shri Swaminathan do not agree, we recommend that the following States, which will be in need of assistance after the transfers to them by devolution of taxes and their share of the grant in lieu of the tax on railway passenger fares and the proceeds of additional excise duties as recommended by us, be paid sums specified against each of them as grants-in-aid of their revenues in the respective years indicated below under the substantive part of Clause (1) of Article 275 of the Constitution :

(Rs. crores)

State	Total of the sums to be paid in the five years	Grants-in-aid to be paid in				
		1969-70	1970-71	1971-72	1972-73	1973-74
1	2	3	4	5	6	7
Andhra Pradesh . . . . .	65.01	15.54	14.27	13.00	11.73	10.47
Assam . . . . .	101.97	90.89	20.60	20.39	20.19	19.99
Jammu & Kashmir . . . . .	73.68	16.81	15.77	14.74	13.70	12.66
Kerala . . . . .	49.65	9.93	9.93	9.93	9.93	9.93
Mysore . . . . .	17.99	6.48	5.04	3.60	2.16	0.71
Nagaland . . . . .	77.95	17.40	16.49	15.59	14.69	13.78
Orissa . . . . .	104.67	24.51	22.72	20.94	19.14	17.36
Rajasthan . . . . .	51.49	12.36	11.33	10.30	9.27	8.23
Tamil Nadu . . . . .	22.82	6.61	5.59	4.56	3.54	2.52
West Bengal . . . . .	72.62	22.29	18.41	14.52	10.64	6.76
<b>TOTAL</b>	<b>637.85</b>	<b>152.73</b>	<b>140.15</b>	<b>127.57</b>	<b>114.99</b>	<b>102.41</b>

These sums include the amounts required to cover the residual deficits of the States on the basis of the assessments made by us, which have been distributed in equal instalments over the five years. They also include supplementary amounts which have been allowed on a diminishing basis as a measure of transitional assistance to the States in respect of losses on departmental commercial schemes and investments, recovery of interest and loans, lower tax effort and higher level of expenditure, for which adjustments were made by us in the assessment of their deficits.