

## Chapter II.

### Federal Grants-in-Aid : Nature and Perspectives.

One of the most important and significant features in the evolution of inter-governmental relations in India has been the growth of the system of grants-in-aid. (1) It is generally used to establish a uniform standard of efficiency among the units of federal political system along with the maintenance of their "jealously guarded autonomy". (2) However, any discussion of the evolution and operation of this grants system should begin, like any other thing, from its definition, objectives or purposes, forms, basis, significance, advantages and disadvantages etc., that is to say, from certain factors required for the purpose of basic understanding of the notion of grants-in-aid.

According to the Encyclopaedia of the Social Sciences, "A grants-in-aid is a sum of money assigned by a Superior to an inferior governmental authority either out of the exchequer of the former or out of sources of revenues specially designated". (3) Encyclopaedia Americana defines it almost in a similar manner : Grants-in-aid is "a sum of money" appropriated by "one level of government" to be spent by a governmental unit "at a more localized level" for a "specified purpose". (4) This grants-in-aid may be said to have several distinguishing features, the most important of which, is perhaps, that they are paid by a

superior governmental authority to a subordinate one. A grant is generally "a gift with several conditions attached to it, but once given it cannot be taken back provided the conditions are satisfied. These conditions vary according to the purposes for which the grant is given. The purpose may be the execution of a project in which the country as a whole is interested ... or it may be the equalization of resources of the various agencies receiving the grant..." (5)

However, grants may also be of a nature where no condition is attached, i.e., the recipient is free to utilize the grant in a way it deems necessary. Every federation has produced a fundamental disequilibrium between the distribution of functions and the distribution of financial resources as a result of which the national government has emerged with greater resources than it needs to perform its functions, while regional governments have been left with more functions than they can pay for. (7)

One of the ways by which this imbalance may be removed is grants-in-aid to the states made either for general or for specific purposes. (8)

A grant should be distinguished from other forms of fiscal transfers made by a national government to the units of a political system. Grants are different from what is known as shared-in-tax. The latter carries with it an element of compulsion on the part of the higher authority. For example, the Government of India is obliged under Article 270 of the Constitution to share

the proceeds of the taxes with the States. Similarly a grant is to be distinguished from a compulsorily assigned tax, an example of which is the estate duty on property other than agricultural land that is assigned to the States under Article 269 of the Constitution of India. Again, a distinction should also be made between a grant and a loan. Even if a loan is given by a higher authority to a lower one "at favourable terms", it has to be repaid. A grant-in-aid, however, need not be returned; the work undertaken is all that remains as a proof of the grant. (9)

The problem of non-correspondence between the functions allotted to each layer of government in a federation and the sources of revenue assigned to enable it to perform those functions has become virtually a common feature of almost all federal political systems of the world as has been already revealed. This problem of federalism is the problem of vertical fiscal imbalance. (10) Again, another fiscal problem arises when both national and unit governments perform similar or related functions. In that case "there arises overlapping of national and unit governments' expenditures" which may be termed as "vertical federal expenditure overlapping". (11) Besides, when all the unit governments perform the same functions within their own respective boundaries but which are adjoined to each other's horizontal federal expenditure overlapping arises. (12) These overlapping of functions may be termed as vertical and

horizontal federal expenditure overlappings because their economic effects overlap on the same people vertically and horizontally creating corresponding impact on the federal balance of power as a whole. Grants-in-aid is one of the major forms of federal fiscal transfers (the others being Tax-sharing and Debt Adjustment in this respect) which is used to solve those fiscal problems and it flows from the national government which finds financial surpluses, to unit governments which face deficits, with a view to reducing the degree of fiscal imbalances. (13)

In recent times, grants-in-aid have been used in various forms to correct distortions in the allocation of national resources and to promote economic development. Broadly speaking, grants-in-aid may be classified as "statutory" and "discretionary". (14) The former is given under the provisions of a Constitution (viz., Art. 275 of the Constitution of India) and that is more or less obligatory on the part of the national government, while the latter, also given under some constitutional authority, does not involve any compulsion for the national government. (15)

Grants-in-aid may also be classified into "allocated" or "substantive" grants and "block" grants --- the former being made for particular service, specified when the grant is given (e.g., central grants to units for particular schemes for education such as education for handicapped), while the

latter may be given in aid of "a general purpose" without detailed specifications regarding the items on which the money should be spent. <sup>(16)</sup> But more frequently from the standpoint of its nature, grant-in-aid may be categorised into "unconditional" (or "general") and "conditional" (or <sup>(17)</sup> "specific") grants. "In so far as the purpose of the grants-in-aid of the revenues of the states is to equalize the standard of services, a measure of inequality in the grant per head may be built in the federal grants depending upon the fiscal needs of the states and their taxable capacity. They may be unconditional, that is, not attached to any specific purpose and there may not be other conditions as to how they should be spent. In the case of conditional grants purposes are attached and there may also be matching provisions to ensure that the states supply a part of the <sup>(18)</sup> cost".

In the American federal polity, where the system of grants-in-aid has perhaps played the most significant role in "balancing the financial position of various units of government" than any other federal political <sup>(19)</sup> set-up of the world, grants-in-aid are usually categorised in two ways by the means administered; for example, "formula grants" (grants allocated to recipients specified by a statute) as opposed to "project grants"

(allocated on a case-by-case basis), or by the conditions attached to their use. If grants are categorised by condition with respect to use, four basic types can be identified: (20)

(1) Categorical (or conditional) matching grants, open-end. These grants offering limited use for specified objectives — require the recipient to match a fraction of the grant. No upper limit is posed to the offering.

(2) Categorical (or conditional) matching grants, closed-end. These grants are in the same category as the above, except that there is an upper limit to the offer.

(3) Categorical (or conditional) grants, no matching, closed-end. These are grants limited to use for a specified objective or determined magnitude for which no matching on the part of the recipient is required.

(4) General unconditional grant. This is a grant in which the recipient is free to use the funds as desired. For this no matching Provision is required. (21)

The grants which are made by the national government to the unit governments may be absolutely unconditional or relatively unconditional. "If the unconditional grants are given to the unit governments regularly without attaching any condition whatsoever either for receiving or for using that grant money, they become

absolutely unconditional. But if unconditional grants are made by the national government to the unit governments by attaching some conditions for qualifying or entitling them to receive the grants, they become relatively unconditional. In this case, conditions are attached only at the receiving end, and that is all. If conditions are attached for using the grants, then they become conditional grants."<sup>(22)</sup>

Conditional or "tied" grants have grown in importance in most of the federal systems on account of their effectiveness in achieving many policy objectives. These conditional grants are called by different names such as "functional" grants, as they are made to promote particular functions of the recipient governments, "specific purpose" grants, as they are made to be used for specified purposes, and "plan" grants,<sup>(23)</sup> as they are intended for undertaking development projects.

Conditional grants may be divided into "matching" and "non-matching" grants. In the case of the former the receiving government is required to match the amount of grant by its own contribution for the purpose for which conditional matching grant is given and in the second case, this matching requirement is absent.<sup>(24)</sup> "Open-end" and "closed-end" grants are in fact two varieties of conditional matching grants; the method of keeping the contribution of the national

government open to any amount provided the unit governments are prepared to match it, is called open-end conditional matching grant and where the conditional matching grant provided by the national government is fixed or limited or subject to an upper-limit, it is known as closed-end conditional matching grant. <sup>(25)</sup> Again, conditional grants may take the forms of "fixed" matching conditional grants or "variable" matching conditional grants. In the case of fixed matching conditional grants the national government may provide a uniformly fixed proportion of the total costs of all the functions or purposes it wants to promote in all the constituent units or it may provide a uniformly fixed proportion of some cost of all the function or purposes it wants to promote in all constituent units or it may provide uniformly fixed proportion of matching conditional grants to all the constituent units without relating to the functions promoted or both. But in the case of variable matching conditional grants, it may provide varying proportion of the total costs of different functions it wants to promote in all the constituent units or it may vary its grants between functions as well as between constituent units. <sup>(26)</sup> Both unconditional and conditional grants-in-aid are justified for a long time as effective means of reducing vertical and horizontal fiscal imbalances in a federation. <sup>(27)</sup>

Unconditional grants are generally supposed to be in keeping with federal principles because they enable the states to supply services according to their special needs. Since the country is heterogeneous, the states may not agree either to the purpose for which the grants may be spent or as to the standard of expenditure. Because their needs differ, the states will want grants without strings. Moreover, the fact that under the constitution the states have original powers, will enable them to demand that the purpose of expenditure will be determined by themselves. (28)

If grants are conditional, they are usually given for specific purposes. These specific purpose grants are justified on grounds of (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." (29)

Some of the circumstances under which grants-in-aid may become necessary are : the extremely low per capita income in certain areas of the country and the need to bring them at par with others; the lack of planning in urban areas because of haphazard growth leading to problems in public health, sanitation etc., and the need to rectify them; the extremely limited and narrow tax-base in some areas as a result of which the state or the local authority becomes unable to raise enough resources by taxation; the inability of the state or local authorities to raise funds at economical rates and high overhead costs due to heavy burden of debts; and, the cases where the responsibilities of the local or state authorities to render services are not matched with adequate fiscal capacity. Besides, another factor that has given enormous impetus to the system of grants-in-aid is the realisation by the people that the governmental authorities which are most suited to administer public services are not always the best to raise revenues to implement these services. From the standpoint of efficiency, effectiveness and popular control it does not necessarily follow that financial responsibility should always be coupled with executive responsibilities and, therefore,

governmental functions should be assigned to those agencies which can most effectively and efficiently perform them and the function of collecting revenue to those agencies of government which are capable of collecting and assessing them. (30) Thus, the rationale of the system of federal grants is to be found in the fact that paucity of funds in a particular area should not be responsible for keeping that area permanently poor and that there are some services which, though of regional nature and interest, may have importance from the national view point and which, therefore, demand attention from the federal government.

"Federal grants for specific purposes (i.e., conditional) or general aid (i.e., unconditional grant) are superimposed upon the general scheme of federal finance adopted in the Constitution" says an eminent writer, and he continues: "such grants overcome state-federal disequilibrium of resources resulting from the constitutional arrangements (i.e., vertical imbalance). They are, therefore, marginal adjustments. They should also be used to overcome interstate disequilibrium which results from regional heterogeneity (horizontal imbalance). In order to maximize national welfare such grants should be based on some criterion of need and would obviously be discriminatory. Grants for specific

purposes, when based on some criterion of need, are doubly effective in bringing about inter-state equilibrium if the purposes selected are such that greater benefit goes to more needy states. The basis of determining needs should not be arbitrary but must be definite and precise in order to avoid inter-state jealousies and political bargaining. It must be based upon some simple and workable principle so that it can be easily adopted in allocating grants." (31)

Per capita income may be treated as a reasonably adequate measure of the relative economic capacity of the states, although there are difficulties in adopting them, as they ignore differences in costs of living and variations in the distribution of income. (32) The Nehru-Adarkar Report came to the conclusion that in the allocation of grants the fullest consideration will have to be given to all relevant factors, including the size of the population, wealth of natural resources, the existing backwardness of the areas concerned, the geographical density of population, the per capita income and wealth of the peoples of the provinces, and their basic needs. (33) To R.N. Bhargava, the deficiencies of per capita income as a measure to judge relative economic capacity of the States, do not seem to carry much weight, while to allow for all the factors mentioned in the Nehru-Adarkar Report will need so many

corrections and adjustments as to make the final index of need too arbitrary and hence he considers that the per capita income figures, along with total population, after making some allowance for sparsity of population, will give a reasonably satisfactory index for allocating grants, so that the allocations may tend to achieve the maximum increase of national welfare. (34) It can not be denied that the per capita income and population figures, as also those of sparsity of populations (indicated by density of population figures) are easily available and these are simple and easy to grasp but it is necessary to consider total population, otherwise a very small state with a very low per capita income may receive much more aid than otherwise justified and some allowance for sparsity of population is necessary. "The per capita income figures indicate the economic backwardness or progress of the different areas, as agricultural and industrial production which depends upon economic development is reflected in them. In economically developed areas there is higher production and, consequently, higher per capita income. It is true that the cost of providing government services varies from state to state. Usually these costs will be low where the price level is lower. With the lower price level the total production of wealth in that area will also be valued lower in monetary terms, and, therefore, per capita income will also be lower. In this way the cost of providing services is indirectly reflected in the

per capita income indices. So also is the effect of the wealth of the people or the advantages of natural resources, in so far as they assist to produce larger incomes. There is no need to take any separate account of differences due to them. (35)

In India, the First Finance Commission in its Report in 1952, after making a survey of the evolution of grants-in-aid in India and other countries of the world

The basis of grants in India: some features. enlisted some major principles or criteria that should determine the quantum of grants-in-aid:

(i) budgetary needs of the States, subject to suitable corrections to ensure compatibility with others; (ii) tax effort of a State-allowance being made for "clear cases" of failure of a State to help itself by imposing higher taxation; (iii) economy in expenditure by a state - this being considered necessary to avoid introducing a premium on extravagance; (iv) standards of social services which may be of inferior type arising from special difficulties such as sparsity of population or economic backwardness; (v) disabilities arising from special obligations of national concern, such as, consequences of "partition"; (vi) broad purposes of national importance should be encouraged - grants may be given to further any beneficent service of

primary importance in regard to which it is in the national interest necessary to assist the less advanced states to go forward. <sup>(36)</sup> As regards the relative role of unconditional and conditional grants in the scheme of financial assistance by the federal authority, the First Finance Commission admitted that, "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," <sup>(37)</sup> and hence this Commission believes 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 judgement, 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" <sup>(38)</sup>. The principles governing distribution of grants-in-aid prescribed by the First Finance Commission have been considered unexceptionable by subsequent Finance Commissions, <sup>(39)</sup> although each of the Commissions made

necessary modifications in its approach. The Report of the Seventh Finance Commission in 1978, however, in recommending its principles that should govern the distribution of statutory grants under Art.275 lays down :

"We have given attention to the principles which should govern the grants-in-aid of the revenues of the States under Article 275. A set of principles was adopted by the First Commission. These were broadly endorsed by subsequent commissions. Some of those principles were more in the nature of guidelines for the internal work in the Commissions in the matter of re-assessment of the revenue forecasts of the States. Some related to areas which have since then become clearly established as being within the purview of the Planning Commission. The later Finance Commissions also had serious difficulties in the application of some of these principles, for instance, measurement of the effects of economy and efficiency in expenditure or assessment of the comparative tax efforts of the States; under the present circumstances according to this Commission :

" (a) Grants-in-aid may, in the first place, be given to States to enable them to cover fiscal gaps, if any are left after devolution of taxes and duties, so as to enable them to maintain the levels of existing services in the manner considered desirable by them and built in their revenue

forecasts. In this connection consideration should be given to the tax effort made by the individual States in ~~the~~ relation to targets for the Plan, to economy in expenditure consistent with efficiency and to prudent management of public sector enterprises.

(b) Grants-in-aid may be made as correctives intended to narrow, as far as possible, disparities in the availability of various administrative and social services between the developed and the less developed States, the object being that every citizen, irrespective of the State boundaries within which he lives, is provided with certain basic national minimum standards of such services. While the long term objective may be to provide to each citizen these services at the levels obtaining in the most advanced states, due regard should be had to the feasibility of upgrading these standards in the shorter term.

(c) Grants-in-aid may also be given to individual States to enable them to meet special burdens on their finances because of their peculiar circumstances or matters of national concern".<sup>(40)</sup> Turning to the centre-state transfers under the auspices of the Planning Commission, this Finance Commission suggests that the Central Assistance for the State Plans in India is to be made in accordance with a formula settled in the National Development Council in which all the States participate.<sup>(41)</sup>

On the whole, the "attainment of broad objectives like growth of national income, price stability, full employment and

social security and welfare by which the centre will be judged is dependent to a large extent on the States' willingness and ability to pursue proper courses of action in their own spheres. Education, medicine, health, poor relief, local employment exchange etc. need close local supervision, sympathy and interest so as to be fit subjects for State operation. On the other hand, technical and vocational education, control of infectious diseases, unemployment insurance, are matters in which the centre would be largely interested .....

Research and experimentation in many matters are costly and exchange of information, coordination of policies etc. can best be done at the central level".<sup>(42)</sup> Therefore, it is easily understandable that "to induce the States to follow enthusiastically the central policy the latter find very useful the method of conditional grants which are used to combine advantages of national planning and local interest and administration in matters left generally to States.....

..... The Centre has not necessarily more foresight or better wisdom ..... But in matters where harmonization of State interests is essential, the Centre will have a better vision and perspective ..... If the Centre has a natural surplus, it has to handle a technique in grants which can be easily used as an inducement for the needed uniformity and coordination with the enthusiastic cooperation of States".<sup>(43)</sup>

But there are difficulties too. "Since States have to be

largely left to perform the necessary services, they must also feel interested in the efficient and economical performance of these activities. This can only be done on a fair matching basis. Insistence on certain technical conditions, standards of service, norms of performance, etc. are no substitute for this. Further, in the absence of such provision the State demand for Central services becomes insatiable".<sup>(44)</sup>

Conditional grants may help stimulate and initiate state expenditure in directions which may have no spontaneous appeal to the States; if the directions are well chosen this is always welcome but when they cover a wide field, they may bring about a distortion of State resource allocation widely out of line with States' needs and tests. And hence the possibilities of States being able to develop themselves in diverse ways in different directions according to their resources, requirements and preferences, which is the essence of a federal system, will be thwarted.<sup>(45)</sup> Pressures resulting from conditions attached to grants may result in unsound methods of financing, especially in backward States, which left to themselves might not have spent much out of their own resources on assisted schemes and which are now led to spend much more neglecting their most essential duties which are not assisted.<sup>(46)</sup> However, it may sometimes be possible to remedy this situation partially by prescribing different rates of central assistance for different States,

but there are limits to the extent of Central grant; the share of the States must remain substantial if the incentive to economise is to remain and this may prove excessive for the poorer States. (47)

Unconditional grants, unlike conditional ones, have a two-fold objective : the units of a federal system have different levels of economic prosperity, and they, therefore, can afford different levels of service for their own people; at the same time, it is not desirable for the interest of the nation as a whole that more than a certain extent of disparities in State services (or, as a matter of fact State incomes) be allowed to persist. Equality of opportunity is a basic requirement in a nation and this demands a particular level of State as well as federal services. Free trade with the entire territories, freedom for persons to travel and settle down in any part of the country, and to pursue any business or vocation without encroachment are regarded as essential features of a federal type of polity. It is necessary to ensure that these arrangements not only work in national interests as a whole, but also in long term interests of the regional units and do not lead to the aggravation of regional inequalities; they must result in national economic integration. Common federal taxes and services, expansion of defence functions and services for international relations etc. account for elevation of standard of governmental activities. The national

government must, therefore, run to the rescue of the poorer states for creating a Common service-standard, and the best way of ensuring this would be through grants-in-aid. If the units are interested in and under pressure to supply some services, in any case, the only barrier being the ability to pay, unconditional grants will do the job of equalization much better than conditional grants without making any serious deviation to the existing "sharing rule". These would also leave enough freedom to the unit-governments to follow their own needs and tastes in detail. Unconditional grants, in a way thus, may be considered as better balancing device (along with tax-sharing) and a better panacea to the chronic dilemma between needs and power to gather money from own resources- that all unit-governments face.

(48)

Indeed, two specific grounds are generally provided as justifications for the existence of unconditional grants as a type of federal fiscal transfer intended to reduce vertical and/or, horizontal federal imbalances of power. First, it is argued that all citizens of a federation should be provided with a uniform minimum level of public services irrespective of the constituent unit in which they live. This requires that all the units must render more or less the same uniform minimum level of public services - mostly of the nature like maintenance of law and order, administering justice,

general administration and so on. But vertical and horizontal fiscal imbalances may prevent the units from providing a reasonably fair level of public services and hence the national government is required to make assistance of financial nature. It is better to provide unconditional grants to the units for this purpose leaving the units free to allocate these among various public services depending upon their relative preferences. In the Second place, it is said that in a welfare State, all citizens of federal community, irrespective of their residential region, must be provided with certain minimum quota of "merit goods", viz., education, health, housing facility etc.. In a federal set-up most of the functions relating to the supply of merit goods are generally assigned to the unit governments on grounds of administrative efficiency, although, not all the units may be in a position to provide them due to lack of funds. Therefore, responsibility rests on the national governments to give financial assistance to the units so that they may be enabled to render these socially desirable minimum quantity of merit goods. Unconditional grants are considered best suited for the purpose, since, this leaves the governments of the units to design the supply of the merit goods consistent with varying tastes, preferences and needs of different constituent units. However, unconditional grants for ensuring minimum quantity of general merit goods have got to be distinguished from the conditional

grants meant for providing specific merit goods with a view to protecting the interests of minorities in a federation (e.g., a state like Uttar Pradesh may spend the grant on Hindi education ignoring the minority's need for Urdu. In such a situation a conditional grant for the upliftment of Urdu education is justified). However, there may be some practical objections (from fiscal standpoint) to such grants: (a) when unconditional grants are provided side by side with conditional grants for the same broad purpose - a "piling-up" of grants may result in. But if unconditional grants for general purpose of equalizing certain essential public services and merit goods are separated from conditional grants for only catering to the specific merit-good needs of the minority in all the units of a federal system (as exemplified above) - this problem may be avoided; (b) if these unconditional grants are made with a view to equalizing the revenues available to each constituent unit - the intended purpose may remain unachieved, because, this method assumes that the demand for public services and merit goods is equal in all the units and also that the supply of these essential public services and merit goods required to equalize them in the whole federation is equal in all the units. These assumptions inherent in "revenue equalization" method of providing unconditional grants are of doubtful validity. Again, the States receiving the grants, may not use them to increase public services,

but substitute them for own finance and hence "reduce taxes". The result will then be a redistribution of disposable private income between regions. Such redistribution may be regressive in effect between units which comes in conflict with the very objective of horizontal federal fiscal equalization. Thus, it is suggested that unconditional grants intended for horizontal equalization of essential public services and merit goods should be made on the basis of the relative 'fiscal needs' of the constituent units. The afore mentioned practical objections may be remedied by providing unconditional grants on the basis of fiscal need - which may be stated in a simple way to be equivalent to an "objectively determined expenditure needs minus revenue means". Unconditional grants on fiscal need basis necessitates the services of an advisory 'expert body to determine the minimum level of essential public services and merit goods to be provided, to estimate the fiscal needs of the units and to recommend the required amount of grants-in-aid. (49)

In conditional grants - which are those fiscal transfers made by the national government to the units with certain conditions attached including some matching self-effort and some standards of design and administration of the programme for which the grants are given - the emphasis is placed more on the objective of

Conditional Grants.

achieving efficiency in the allocation of federal fiscal resources in the national economy of a federal political system. These conditional grants are justified on some specific grounds for reducing distortions in the efficient allocation of national resources in a federation; for providing some minimum level of merit goods to all citizens of a federation; for providing relief to those who would be adversely affected by unforeseen natural devastations; for promoting certain nationally important activities in general; and for promoting economic development of the whole country in particular. There is no gainsaying the fact that these are all economic justifications by nature. but it is also wellknown that a federal system is both a political and an economic organization and hence economic implications of those justifications for grants must not lose sight of its political upbringings which are ~~is~~ almost inherent in those justifications. (50)

Conditional grants increase the resources available to the recipient unit government and encourage expansion of their expenditures for which the grant is made. But they may or may not reduce their expenditures on other non-aided programmes. Whether conditional grants encourage the unit governments to hold constant, reduce or increase their own revenues depend upon the nature of the conditional grants -

matching or non-matching grants. Generally, these conditional grants encourage the functions of national importance and thereby benefit the whole nation. Again, they stimulate the interests of the component units and their expenditure in matters in which the entire nation has considerable interest. But some objections to these grants seems to be well founded. Conditional grants are opposed on grounds : that national government tries to interfere into and dictate policies over certain fields which fall within the jurisdictions of the unit governments which may amount to a curb on the financial and political autonomy and centralization or tilting of federal balance of power in favour of the centre; that, these grants may result in uneven or inefficient distribution of unit governments' expenditure among their functions and thus it may distort the unit governments' budgetary policies; and, that by compelling the grant receiving units to match the amount of grant by their own contribution, the conditional grants may result in regressive financial transfers as between economically unequal units in a federation - they become regressive not merely in the sense that these unit governments which can afford matching contributions receive more grants than those which can not afford the matching requirement, but also that those unit governments which are badly in need of grants will have to resort to regressive types of revenues in order to raise matching

revenues to avail themselves of the conditional grants. This can be avoided, however, if conditional grants are in the form of closed-end varying matching grants. <sup>(51)</sup>

The overall advantages and disadvantages of the system of grants-in-aid are many and diversified. This has already been revealed from the discussion  
Pros. and Cons. made above. Still specific factors of real importance may be pinpointed here :

"Grants-in-aid" may help preserve a great measure of self-government. It can be used as a stabiliser of the revenues of the smaller units of government in normal times and as a source of revival in times of depression and emergency.

Grants have been responsible for the maintenance of higher standards of performance by the Unit Governments than would have been otherwise.

This mechanism has established the sound principle that the governmental authorities best suited to collect taxes on a national scale are not always the best suited to use the proceeds of such taxes. <sup>(52)</sup> It provides a significant and useful device by which the national, state and local governments may cooperate in providing services of varied nature and importance and it may also enable the federal government to implement national policies without duplicating

and competing with services provided by the authorities of the Units. <sup>(53)</sup> This may facilitate the exercise of certain measures of federal control as well as coordination over essential welfare services on a national scale. <sup>(54)</sup>

Major disadvantages of grants-in-aid (elaborately mentioned in the discussion that precedes) are as follows:

Grant programmes may be excessively rigid and not amenable to modifications when needed, and thereby make it difficult to transfer funds to projects that are most useful to the receiving authorities. The conditions attached to the grants may often be such that they give too much arbitrary powers to the officials of the grants-giving departments. The matching provisions sometimes tend to strain the economies of the poorer states or units because of their concentration on projects associated with grants in order to qualify to receive them; The grants are beyond the budgetary control of the receiving authorities in most of the cases. Conditional grants are considered as devices of infringement upon the autonomy of the unit governments in a federation.

Notwithstanding the presence of several criticisms and contradictory views, the fact remains that the system of grants-in-aid has come to stay and it has become a regular feature in the various systems of financial arrangements in almost all the countries of the world having a federal set-up. <sup>(55)</sup>

In India, as in many other countries, grants-in-aid have a clear basis in the provisions of the constitution itself.

With regard to the forms of grants-in-aid and their suitability, it is often argued that the conditional grants fit into the doctrine of "financial responsibility" - but the fear that the unconditional grant leads to extravagance and waste is not always correct. When such grants are for general aid the burden of state extravagance falls directly on its own people. The principle behind the unconditional grants recognises the fact that needs of different states may vary and each of them ought to be free to incur expenditure in performing its functions in the manner most suited to the region concerned. When there are deep-rooted reasons for diversity, uniform conditions are not suitable for all the states. The federal object is not that the aided service is rendered uniformly but that a desirable standard is maintained in the provision of that service. Within this limit there is a considerable scope for diversity in the provision of the service in accordance with regional needs. Conditional grants also poses the problem of selection of the activity which should receive federal aid. Often there are regional pulls for the selection. The states try to have those activities subsidized by the national government in which their own regions are more interested. Where such bargaining results in the selection of

activities from which comparatively richer areas will benefit more - the grants tend to worsen the inter-state disequilibrium, that is, disrupts horizontal balance of power. <sup>(56)</sup> Besides, experience "in the leading federations have shown that the irritating conditions involved in specific grants are tolerated only under exceptional circumstances which defy marginal solution. Nevertheless, it is easily understood that the spirit of cooperation is best promoted through mutual trust rather than by mutual suspicion. From this point of view, unconditional grants, determined on an objective basis appear to be the most suitable in the new federations where sub-national currents are still running strong." <sup>(57)</sup> However, in terms of economic policy implications of the federal fiscal transfers or from the stand-point of the national government providing assistance to the unit governments, "Conditional grants are superior to unconditional grants as the former enable the national governments to promote more than one objective at a time." <sup>(58)</sup>

Articles 273, 275, 278 and 282 of the Constitution of India deal with grants-in-aid. Out of these, Art. 273 dealing with grants to four jute producing States have become virtually obsolete from 1960. Art. 278 which originally dealt with, inter alia, grants to Part B States, was repealed by the Constitution (Seventh) Amendment Act, 1956. Thus any discussion on the system of federal grants in India should

concentrate, in the main, around Articles 275 and 282. <sup>(59)</sup>

Grants that were being given under Articles 273 and 278 and grants that are now given under Art. 275 on the recommendations of the Finance Commissions are unconditional grants. While those which are made under Article 282 are specific, <sup>(60)</sup> that is, conditional by nature. But before one enters into those provisions of the Constitution of India, it is desirable ~~for us~~ to look into the system of grants-in-aid prevalent in major federal systems of the world.

Chapter II

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