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CLASSIFICATION OF GRANTS-IN-AID RECOMMENDED BY THE FINANCE COMMISSION

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Abstract: **Grants-in-aid form a major route of fiscal transfers from the Central Government to the State Governments. The following paper attempts to study the categorisation of these grants made by the various Finance Commissions since 1951. Grants-in-aid can be broadly classified into two classes- Unconditional Grants and Conditional Grants which are further categorised into different types of grants.**

Keywords: **Grants-in-aid, Fiscal transfers, Finance Commission, Fiscal Federalism.**

I. INTRODUCTION

As per the Terms of Reference of the various Finance Commissions, they are required to make recommendations on the principles which should govern the grants-in-aid of the revenues of the States out of the Consolidated Fund of India and 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 of the Constitution of India for purposes other than those specified in the provisos to clause (1) of that article. As the system of grants has evolved in India, grants flow from the centre to the states in three ways. The first consists of grants-in-aid given under the recommendations of the Finance Commission. The second category consists of plan grants covering central assistance for state plans as decided by the Planning Commission, as well as the plan grants given by the central ministries for implementation of plan schemes. The third type of grants, which is much smaller in magnitude, essentially consists of discretionary grants given by the central ministries to states on the non-plan side. The First Finance Commission laid down six principles under which grants-in-aid should be recommended – budgetary needs, tax effort, and economy in expenditure, standard of social services, special obligations and broad purposes of national importance of the states. Later the Seventh Finance Commission reformulated these principles into three broad principles – firstly, grants to cover fiscal gaps in accordance with the tax effort, economy in expenditure and prudent management of public sector enterprises, secondly grants to narrow the disparities in the availability of various administrative and social services so that minimum standards of such services are provided and thirdly grants to meet the special burden on state finances on account of issues of national concern.

II. CLASSIFICATION OF GRANTS-IN-AID

The grants recommended by the various Finance Commissions can be broadly classified into two categories:

a) **General purpose/ Unconditional/ Untied Grants** -

These grants add to the revenues of the state governments without conforming to any conditions. States have full autonomy to allocate the sums received under these grants.

b) **Specific purpose/ Conditional/ Tied Grants** –

These grants are recommended for specific purposes/schemes and are subject to certain conditionalities. Such grants are driven by the principle of 'need' of a particular service in a state.

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I. Unconditional Grants –

These grants can be further classified as:

i. ***Compensatory Grants*** –

These grants are recommended on account of loss of important sources of revenues for the states. These include:

- Ad-hoc grants-in-aid to West Bengal, Assam, Odisha, and Bihar in lieu of their share of the jute export duty.[2]
- Ad-hoc grants-in-aid in lieu of railway passenger fares tax under the repealed Railway Passenger Fares Tax Act, 1957.[3]
- Ad-hoc grants-in-aid on account of wealth tax on agricultural property.[4]
- Grants-in-aid to compensate for revenue losses due to phasing out of all indirect taxes and implementation of Goods and Services Tax.[5]

ii. ***Block/ broad purpose Grants*** –

These grants are given to stimulate the expansion of particular categories of services rather than specified schemes under those categories. Hence, block grants are only partially unconditional grants as broadly they are conditioned on the area wherein these sums are to be spent but the states are free to choose individual schemes within that particular area.

iii. ***Deficit/ Gap Filling Grants*** –

These grants act as residuary assistance to cover up the Non-Plan Revenue Expenditure deficit of the states that exists even after the tax devolution from the central government.[6]

II. Conditional Grants-

These grants can be further classified as:

i. ***Input or Output based Grants*** –

Those conditional grants wherein conditions are imposed to acquire the grant for a particular service are called input based and those wherein conditions are imposed on the service delivery are called output based conditional grants.

ii. ***Matching or Non-matching Grants*** –

Under matching grants, recipients are required to spend a specified percentage from their own resources unlike in the case of non-matching grants wherein no such requirement is imposed. Matching grants can be of two types:

- **Open-ended** – where grantor matches the level of resources provided by the recipient.
- **Closed-ended** – where grantor matches only a pre-specified limit of the level of resources provided by the recipient.

iii. ***State specific / Special needs Grants*** –

These grants are recommended on account of special problems or obligations of the states which include the following:

- Special Development Grant to finance specific development schemes to remedy special backwardness of the states.[7]
- Grants for improvement of communications facilities.[8]

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[2] Recommended by the First Finance Commission.
[3] Recommended by the Fourth Finance Commission and then again from Sixth Finance Commission to Tenth Finance Commission.
[4] Recommended by the Sixth, Seventh and Eighth Finance Commissions.
[5] Recommended by the Thirteenth Finance Commission.
[6] Grants-in-aid are recommended by the Finance Commission under Article 275 which puts no restriction or bar against making grants for capital expenditure. Moreover, Finance Commission makes assessment of the needs of the states to the extent of requirements on the non-plan account because plan requirements are best determined on an annual basis and states determine their plans in consultation with the Planning Commission, which is charged with determining plan grants.
[7] Recommended by the First Finance Commission.

- Special grants for border roads and maintenance and development of border areas.[9]
- Grants for financing calamity relief expenditure in the states.[10]
- Grants to cover net additional interest rate liabilities on fresh borrowings.[11]
- Grants for state specific Centrally Sponsored Schemes.[12]
- Centre's contribution for margin money requirements.[13]
- Grants for heritage conservation i.e. protection of historical monuments, archaeological sites etc.[14]

iv. ***Maintenance Grants*** –

Maintenance grants are provided for maintenance of assets including construction of roads, buildings, irrigation works, flood protection works and other infrastructure[15]. Moreover, it is necessary to ensure using effective monitoring mechanism that these allocations are utilised for this purpose only and do not get diverted to other uses.

v. ***Upgradation Grants*** –

These grants are recommended for Upgradation in standards of administration and social services. Initially the Sixth Finance Commission had considered the requirements of States which were backward in standards of general administration with a view to bringing them to the levels obtained in the more advanced States. It took the view that a Finance Commission was basically concerned with expenditure on revenue account and therefore recommended Upgradation grants for meeting the revenue expenditure deficiencies of certain States in areas like: general administration, administration of justice, jails, police, primary education, medical and public health and welfare of scheduled castes, scheduled tribes and other backward classes. The Seventh Commission had considered Upgradation of standards in non-developmental sectors and services. The Commission restricted the scope of grants to administration of taxes, treasury and accounts administration, judicial administration, general administration, police and jails. Like the Seventh, the Eighth and the Tenth Commissions also considered non-developmental sectors. However, both these Commissions recommended grants for developmental sectors like education and health as well. The Commissions also recommended a mechanism to monitor the utilization of Upgradation grants.

vi. ***Equalisation Grants*** –

The Twelfth Finance Commission introduced equalisation grants in health and education in order to equalise states with respect to these two crucial developmental sectors by providing grants-in-aid to those states where the levels of revenue expenditure were lower relative to the average expenditure.

vii. ***Incentive/ Performance Based Grants*** –

The Thirteenth Finance Commission recommended these grants to improve policy outcomes in states thereby incentivising the states to enhance their performance. These grants would help to:

- Reduce Infant Mortality Rate.
- Improve supply of justice.
- Incentivise for issuing UIDs.
- Set up District Innovation Fund.
- Improve statistical systems of state and district level.
- Improve employee and pension database.

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[8] Recommended by the Third Finance Commission.
[9] Recommended by the Fifth Finance Commission.
[10] Recommended since the Eighth Finance Commission.
[11] Recommended by the Eighth Finance Commission.
[12] Recommended by the Ninth Finance Commission.
[13] Recommended by the Eighth and Ninth Finance Commission.
[14] Recommended by the Twelfth Finance Commission.
[15] Recommended by the Sixth and Twelfth Finance Commission.

viii. ***Environmental grants*** –

The Thirteenth Finance Commission recommended environment related grants to conserve ecology. These comprise of:

- Forest grants calibrated to national forested area in each state.
- Grants for generation of grid electricity from renewable resources.
- Grants to establish independent regulatory mechanism for water sector management and irrigation.

ix. ***Grants for local bodies –***

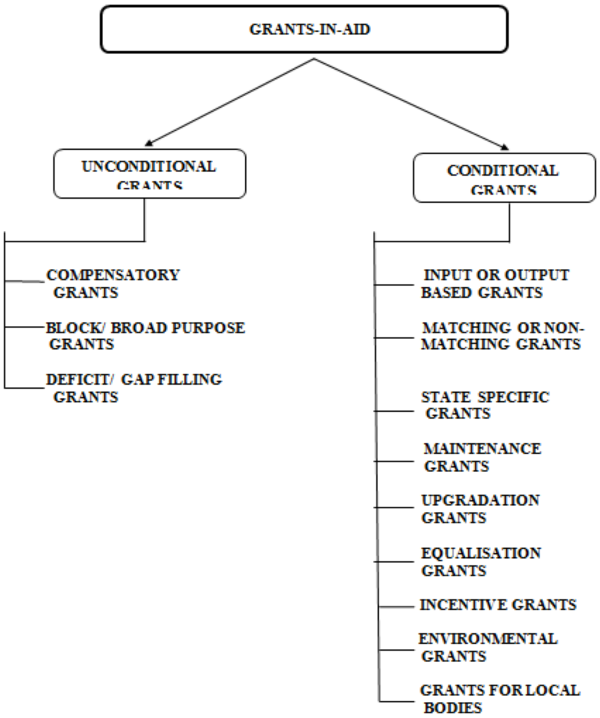
Following the 73rd and 74th amendments to the Constitution of India, the Finance Commissions were charged with the additional responsibility of recommending measures to augment the Consolidated Fund of a State to supplement the resources of local bodies. This has resulted in further expansion in the scope of Finance Commission grants. The Tenth Finance Commission was the first Commission to have recommended grants for rural and urban local bodies followed by the subsequent commissions. These grants should initially be used for maintenance of accounts and audit and development of database and the remaining amount should be used for maintenance of core civic services. Moreover, they can be subdivided as:

- General basic grant.
- General performance grant.
- Special area basic grant.
- Special area performance grant.

Thus, over the years, there has been considerable extension in the scope of grants-in-aid. Now the Finance Commission grants cover in addition to meeting the non-plan revenue deficits, requirements of States on account of special problems, environment related grants and partial equalisation of certain basic services. They even cover the capital expenditure needs of States in these sectors.

III. CONCLUSION

In a nutshell, the above classification of grants-in-aid reflects the fact that the two broad categories of grants i.e. conditional and unconditional are comprised of various types of grants under the umbrella of article 275. This categorisation is also shown diagrammatically below.



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