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Provision of Grants- in- aid: Lessons to learn from the US experience

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I. INTRODUCTION

Public administration has evolved over the years entailing delivery of public goods through new and improved methods. Grants-in-aid have emerged as a significant mode of payment for delivery of public goods. They are payments made in the nature of assistance, donation or contribution by one government, body or institution to the other. They are allocated for specific purposes and hence are accompanied by certain standards and requirements set by the governing body for which they have to be spent.

Grants-in-aid are used when the legislature and the government decide that the recipient should be publicly funded but operate with reasonable degree of independence. They have gained so much importance that they have become the single largest item of expenditure for the Union government of India with an exception of debt payments. The study undertaken intends to discuss the types and provisions of grant-in-aid in India and how it could be improved, learning from the grants-in-aid scenario of United States of America.

Grants-in-Aid in India

The Indian Case

In India, Grants-in-aid under Article 275(1) of the Constitution provides such schemes as Parliament may be by law provide shall be charged on the Consolidated Fund of India in each year as grants-in-aids to revenues of such states as Parliament may determine to be in need of assistance and different sums may be fixed for different states. There are two main types of grants issued:

1. Statutory Grants

Article 275 makes provisions for statutory grants to needy states (not every state). These are charged on Consolidated Fund of India. Such grants also include specific grants for promoting the welfare of the scheduled tribes in a state or for raising the level of administration of the scheduled areas in a state including the State of Assam. The bases of these grants are recommendations of finance commission.

2. Discretionary Grants

Under Article 282, both Centre and States are able to make any grants for public purpose even if they are not within their legislative competence. Since such grants are discretionary, there are no obligations to make such grants. During the era of Planning Commission, these discretionary grants were in fact bigger than statutory grants and that is why planning commission had assumed a very important role.

In India, it is the Finance Commission which makes recommendations regarding the principles which should govern the grants-in-aid apart from the revenue from tax sharing.

The Union Government in India has accepted the recommendations of the 15th Finance Commission for the award period 2021-22 to 2025-26 relating to the grants-in-aid amounting to Rs 2,33,233 crore to the States during 2021-22 for Post Devolution Revenue Deficit grant, grants to Local Bodies, Health sector grant and Disaster Management grants. The Fifteenth Finance Commission has recommended a total Post Devolution Revenue Deficit grant of Rs 1.18 lakh crore to 17 States in the financial year 2021-22.

With regard to the Grants to Local Bodies, it had recommended that urban areas are grouped into two broad categories for recommending grants to urban local bodies: (a) Category-I cities: urban agglomerations/cities with more than one million population and (b) Category-II cities: other than million-plus cities. The Commission has recommended that for cities with million plus population (Million-Plus cities), 100 per cent of the grants are performance-linked through the Million-Plus Cities Challenge Fund (MCF). Also, 60 per cent of the grants to rural local bodies and for urban local bodies in non-Million-Plus cities should be tied to supporting and strengthening the delivery of two categories of basic services: (a) sanitation,

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maintenance of 'Open Defecation Free' status (for Rural Local Bodies), solid waste management and attainment of star ratings as developed by Ministry of Housing and Urban Affairs (for non million plus cities / Category-II Cities / Towns; (b) drinking water, rain water harvesting and water recycling (both for Rural Local Bodies and Urban Local Bodies).

Grants for health were recommended amounting to Rs 13,192 crore for the year 2021-22. With regard to the Disaster Management grants, the Commission has recommended that the total States allocation for State Disaster Risk Management Fund (SDRMF) should be subdivided into funding windows that encompass the full disaster management cycle. Thus, the SDRF (State Disaster Response Fund) should get 80 per cent of the total allocation and the SDMF (State Disaster Mitigation Fund) 20 per cent. Similarly, the Commission has recommended that NDRF (National Disaster Response Fund) should get 80 per cent of the total allocation of the National Disaster Risk Management Fund and the remaining 20 per cent for National Disaster Mitigation Fund.

Now we shall look at the grants-in-aid to states section of the demand for grants in Budget 2022-23.

Table 1.1
Total Transfer of Resources to States aAnd Union Territories with Legislature (Excluding States' Share of Net Proceeds of Union Taxes and Duties)

Items of Expenditure	2020-21 Actuals	2021-22 Budget Estimates	2021-22 Revised Estimates	2022-23 Budget Estimates
I Some important items of Transfer	164873.40	90055.22	221200.29	163709.53
a. Assistance to states from NDRF	8257.11	12390.77	9000.00	10408.00
b. Loans to states in lieu of GST compensation shortfall	110208.00	0.01	159000.00	0.01
c. Central Pool of Resources for North Eastern Region and Sikkim	197.28	404.50	404.50	
d. Externally aided projects-grants	3431.06 26763.99	3000.00 46750.00	4165.00 27000.00	3722.00 32280.00
e. Externally aided projects-loans	207.45 799.70	220.59 1118.95	220.59 749.80	80.04 1069.70
f. Schemes of Northeast Council	11830.29	10000.00	15000.00	100000.00
g. Provision under Article 275(1)	1996.16 387.00	15000.00	5000.00	15000.00
h. Loans to states for capital expenditure				
i. Special assistance under demand	795.36	1170.40	660.40	1149.78
j. Special assistance to SCs under demand department of Ministry of Social Justice and Empowerment				
k. Special assistance to tribal areas under demand department of Ministry of Tribal Affairs				
II Finance Commission Grants	184062.50	220843.00	211065.00	192108.00
a. Grants for local bodies-Urban	26710.07 60750.00	22114.00 44901.00	14614.00 42623.00	22908.00 46513.00

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b. Grants for local bodies-Rural c. Grants for Health sector d. Grants-in-aid for SDRF e. Grants-in-aid for State Disaster Mitigation Fund f. Post Devolution Revenue deficit grants	22262.43 74340.00	13192.00 22184.00 118452.00	13192.00 17747.20 4436.80 118452.00	13192.00 18635.20 4658.80 86201.00
III Other transfers to States a. Under Centrally Sponsored Schemes b. Under Centre Sector Schemes c. Other categories of revenue expenditure d. Capital transfers	325453.19 308305.59 16143.45 1002.50 1.65	363355.20 318857.20 43016.21 1259.14 222.65	372828.83 326239.51 45123.44 1353.23 112.65	383682.12 333086.65 49026.38 1466.09 103.00
IV Transfer to Delhi, Puducherry and Jammu& Kashmir a. Under Centrally Sponsored Schemes b. Under Centre Sector Schemes c. Other categories of revenue expenditure d. Capital transfers	50667.12 6874.28 1153.53 42639.31	48686.07 8064.63 177.13 45015.25 0.02	53476.47 8319.28 141.93 40444.29 0.01	55631.38 8500.16 251.98 46879.23 0.01
Grand Total	725056.21	722939.49	858570.59	795131.03

Source: Union Budget 2022-23

Learning from the US experience

While examining the criteria for devolution of grants-in-aid followed by the 11th- 15th Financial Commissions, there is a similarity between American and Indian contexts.

i. **Population** is an indicator of the expenditure needs of a state. The 15th Finance Commission used the 2011 population data, in addition to the 1971 data.

ii. **Area** is used as a criterion as a state with larger area has to incur additional administrative costs to deliver services.

iii. **Income distance** is the difference between the per capita income of a state with the average per capita income of all states. States with lower per capita income may be given a higher share to maintain equity among states.

iv. **Forest cover** indicates that states with large forest covers bear the cost of not having area available for other economic activities. Therefore, the rationale is that these states may be given a higher share.

Activities leading up to the enactment of grant-in-aid have followed a familiar general pattern in the US. In the first instance, the question of whether the service provided by the program is of national interest or not is to be answered. The decision process involves elections, hearings, public discussions, committee reports and potential legislative action. If it is decided that the purpose is a matter of national interest, then the various specific devices and arrangements for financing and administering the programs are considered. However in its Indian counterpart, it is decided according to the recommendations of the Finance Commission.

The Centre collects majority of the tax revenue as it enjoys scale economies in the collection of certain taxes. States have the responsibility of delivering public goods in their areas due to their proximity to local issues and needs. Sometimes, this leads to states incurring expenditures higher than the revenue generated by them. Further, due to vast regional disparities some states are unable to raise adequate resources as compared to others. To address these imbalances, the Finance Commission recommends the extent of central funds to be shared with states. Prior to 2000, only revenue income tax and union excise duty on certain goods was shared by the Centre with States. A Constitution amendment in 2000 allowed for all central taxes to be shared with states. Inspite of tax sharing, there arose the need for grants in aid for reducing regional imbalance and for improving the centre-state relationship. A grant is used to fund a specific and agreed activity, while by providing grant-in-aid, central govt could steer the working of states in line of its interests.

Conditional offer of Grants in aid in USA implies that services are financed in part from federal funds and in part funds raised by 48 partial diverse revenue systems. Thus the economic effects of raising substantial amounts of revenue from many interrelated sources formed the economic effects of grants-in-aid. The determination of such effects requires comparison of financing plans with some alternative or standard. The choice of the standard depends up on the objectives of investigation in large measure.

There are however two kinds of standard:

a) A completely abstract standard could be described and used as a basis of comparison. For eg: Geographically neutral standard which is a plan of financing which raises revenue in such a way that similar resource units are treated similarly regardless of their locations. In reality, there is no such plan but each actual plan could be compared with the standard which would point up the particular effect under study.

Advantages of this procedure is that there would be little possibility of including an implicit policy recommendation in a study intended only to set forth the economic effects of a policy decision. Furthermore, an abstract standard can be rather precise and definite one which would make comparison somewhat easier and results conceptually clearer. The standard is ideally abstract but deviations of actual arrangements from the standard can be estimated and are useful in practical affairs.

b) Another plan is when a grant-in-aid plan could be directly compared with any alternative available at the time a decision is about to be made. For eg: When it became clear that the federal government would enact social security legislation, the alternatives as to financing included grants-in-aid a national plan, tax offset plan and others. Effects of each plan would differ and a comparison of grants-in-aid with each other proposal would serve to point up the difference.

The economic effects of fiscal transfers from the Centre to States are critical in India. The design and implementation of general and specific purpose transfers is critical in Indian federation from the viewpoint of not only ensuring horizontal equity but also balanced regional development and overall stability and integrity of the federation. This becomes even more important when the fact that there are significant hindrances to mobility of population and therefore, it is necessary to take capital to the people and not wait for the people to move towards capital. Analytically, general purpose transfers are given to offset fiscal disabilities of the States so that all the States are enabled to provide comparable levels of public services at comparable tax rates. However, given the large variations in fiscal disabilities in Indian States with per capita income in the highest income state is five times that of the lowest income State, it becomes difficult to design the general purpose transfers to fully offset the revenue and cost disabilities. Even the richest state suffers from physical and social infrastructure deficits and therefore clamours for transfers and this poses constraints on the extent of targeting and equalization through instruments like tax devolution. This brings in the importance of specific purpose transfer to ensure minimum standards of services considered meritorious or those with significant inter-state externalities. The Centre can certainly do well to rationalise the centrally sponsoring schemes. In the case of specific purpose transfers, the Centre has to determine the design itself. Here, it is important to limit the number of schemes and fund them adequately to make a difference to service level.

India is known to have adopted a lot of features from the outside world such as the 'Directive Principles of State Policy' from Ireland, 'Concurrent List' from Australia, 'Fundamental Duties' from USSR etc. Thus, India had not been reluctant in learning from the examples of other nations to improve its own conditions. So, in the case of provision of grants-in-aid also, India can learn from US experience and imbibe it into its internal system, making necessary changes to suit its domestic climate.

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