CHAPTER V

GRANTS-IN-AID AND LOANS
GRANTS-IN-AID AND LOANS

Grants-in-aid and loans play an important role in the Central State financial relations in India as in other federations. Despite the shared taxes and assigned taxes (which were discussed in Chapter Four) to the State Governments, the revenue resources of the most of the states are not sufficient to meet their budgetary needs. The financial resources of the state governments by themselves are inadequate to enable them to discharge the socio-economic responsibilities of the states. To reduce the imbalance between the ever increasing functions and the not-so elastic resources of the states, the constitution of India provides certain adjustments under Article 275, Article 282 and Article 293 which are discussed in this chapter.

Grants are one of the forms of inter-governmental fiscal assistance and are essentially transfers or subsidies from the union government to states and other lower forms of government. Grants are normally expected to provide the much needed fiscal equilibrium or equalise the levels of social and other services in different states of the country.

Under Article 275, grants-in-aid of revenue are given to the states through the Finance Commission constituted according to Article 280 by the President of India. According to
the first proviso to Article 275(1) the grants-in-aid enables the states to meet the cost of developmental schemes undertaken for the welfare of the Scheduled Tribes or raising the administrative level of the Scheduled Areas. Specific provision was made under second proviso to meet the cost of developmental schemes in the state of Assam. Article 282 speaks of grants 'for any Public purpose' and Article 293 allows for loans to the State Governments.

The deficiency of resources of the states arises for reasons other than the statutory inadequacy of their resources. The ever rising prices, the periodic increase in the salaries and allowances of the employees, mounting debt of the states and consequent increase in debt servicing charges are some of the factors responsible for this state of affairs. The plan resources are made available for the period of each plan, and on the termination of the plan period, the responsibility for the upkeep of the completed schemes devolves on the states and becomes part of non-plan expenditure. The financial burden of the general inflationary situation has also to be borne by the states. The Union government gives them grants-in-aid.

mostly to meet the budgetary gaps.\(^2\) Achievement of 'economic equilibrium' in the nation as a whole is the most significant goal of fiscal adjustments between different levels of government.\(^3\)

The two types of grants provided under the constitution therefore are statutory grants and discretionary grants. Statutory grants are unconditional and are given to the states without any stipulations through the channel of the Finance Commission. These grants (Article 275) are given to assist the state governments and relieve pressure on state finances. Discretionary grants are conditional and are given to the state governments at the discretion of the Union government (Article 282). The general objective of conditional grants is giving assistance to state governments for promoting welfare. Grants can also be classified as 'Plan' and 'non-plan' grants. Plan grants are determined by the Planning Commission. The non-plan grants are determined by the Finance Commission.

Article 282 was intended to give power to the Union and the states to make grants for special bodies and purposes like U.N and other international bodies and to any state in case of

\(^{2}\) Ibid.

\(^{3}\) J.N. Sharma, The Union and States, Sterling Publishers, New Delhi, 1974, p. 92.
serious natural calamities like famine, floods or earthquake. But Article 282 has become the backbone of federal planning of finances and has provided the basis for making progressively massive grants to the states for implementing the centrally sponsored plan projects and is being used extensively to regulate financial relations between the Union and the States. All capital grants to the States for implementing their share of the plans are made under this Article.

**Article 275:**

In the post independent era the approach and perspective of Niemeyer Award changed to some extent with the new conception of close financial collaboration between the Union and States on the basis of national plan of economic development. But the basic approach of Niemeyer still remains valid; the States and the Union have to balance their budgets within their available resources and the needs of the states, which cannot be met by devolution of shared taxes, have to be covered by grants-in-aid.

The Finance Commission has to formulate the principles which should govern grants-in-aid to the states under Article 275.

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5. Ibid.

The President can also refer other matters to the commission in the interests of sound finance.

**Principles of Grants-in-aid**

The principles formulated by the first Finance Commission for regulating grants-in-aid of revenue of the states are:

1. Budgetary needs of the states, subject to the adjustments to ensure comparability with others.
2. Tax effort of a state, with due allowances for 'clear cases' of failure of states to maximise tax effort.
3. Consideration of reasonable economy in expenditure to avoid a premium upon extravagance.
4. Special assistance to states in which standards of social services are significantly lower than others.
5. Special disabilities of states.
6. Broad purposes of national importance.

The First Finance Commission suggested that the budgetary needs of the states should be the starting point for determining the assistance required by the states. The budget of the states should be reduced to a comparable basis by making adjustments in respect of abnormal, unusual and non-recurring items of revenue and expenditure.⁷

Secondly, tax effort of the state, i.e., the state exploiting its own taxable capacity, determines its eligibility for

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⁷Ibid.
grants-in-aid. Due allowances were made for 'clear cases' of failure of states to maximise the tax effort. The second Finance Commission felt it difficult to decide whether a state is taxing its people adequately in relation to their income and taxable capacity. Therefore, it was considered that if a state raised additional revenue which it has promised for the plan, it will have done its part. 8

Economy in expenditure is another factor in determining the grants-in-aid of revenue to the states. Utilization of resources in the efficient manner is necessary to any state. The main purpose of grants-in-aid is to reduce inequalities in the standards of basic social services in the states. To meet the special disabilities of the states due to abnormal conditions beyond their control, grants-in-aid are provided. Grants may also be given to certain states for furtherance of certain broad purposes of national importance, such as primary education, in respect of which they may be specially backward.

The five Finance Commissions, which followed, the first, broadly endorsed the principles mentioned above as unexceptionable. The seventh Finance Commission formulated the following principles of grants-in-aid. 9

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8 Ibid., p. 25.
1. Grants-in-aid may, in the first place, be given to the states to enable them to cover fiscal gaps, if any which are left after devolution of taxes and duties, so as to enable them to maintain the levels of services in the manner considered desirable by us and built in their revenue forecasts. In this connection consideration should be given to the tax effort made by the individual states in relation to targets for the plan, to economy in expenditure consistent with efficiency and to prudent management of public sector enterprises.

2. 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 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.

3. 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.

The seventh Finance Commission recommended grants to 8 states on the basis of the first principle and to 17 states under
The second principle but confined the grants to non-plan, non-developmental sectors only, like police, jails etc. No grants were recommended to any state under the third principle.

The eighth Finance Commission accepted that the principles of grants-in-aid laid down by the seventh Finance Commission are unexceptionable and broadly agreed with them. It made recommendations regarding the amounts of grants-in-aid that should be given to the states in aid of their revenues.

1. To cover the deficits on revenue account, grants-in-aid may be given to 11 states.

2. To cover the requirements of upgradation and special problems, 17 states are to be paid grant-in-aid of their revenues.

3. To meet the margin money requirements of states, the states are to be paid grants-in-aid of their revenues.

Statutory grants to the states as a share of total statutory transfers (Table 5.1) during first plan period constituted 23 per cent which increased to 27 per cent in second plan period. Though it decreased to 25 per cent in the third plan period, it rose again in the annual plan periods to 29 per cent. But the percentage share of statutory grants in statutory transfers started declining in successive plan periods and reached 5.9 per cent in sixth plan period.
### Table 5.1.

**Composition of Central Budgetary Transfers to the States**

(1981 - 84)

<table>
<thead>
<tr>
<th>Plan periods</th>
<th>I</th>
<th>II</th>
<th>III</th>
<th>Annual period</th>
<th>IV</th>
<th>V</th>
<th>VI</th>
</tr>
</thead>
</table>

1. Percentage share of statutory grants in statutory transfers

|                     | 23.0 | 27.3 | 24.8 | 29.1 | 25.9 | 25.4 | 5.9 |

2. Percentage share of statutory grants in total grants

|                     | 35.3 | 31.7 | 30.2 | 36.0 | 22.4 | 32.1 | 9.4 |

3. Percentage share of loans in non statutory transfers

|                     | 81.2 | 72.4 | 77.3 | 75.1 | 69.3 | 62.4 | 56.3 |

4. Percentage share of tax transfers in total transfers

|                     | 24.1 | 23.3 | 21.4 | 24.0 | 30.2 | 33.0 | 40.6 |

5. Percentage share of grants in total transfers

|                     | 20.1 | 27.5 | 23.2 | 26.0 | 25.4 | 32.2 | 27.4 |

6. Percentage share of loans in total transfers

|                     | 55.8 | 49.2 | 55.4 | 50.0 | 44.4 | 34.8 | 32.0 |

Source: Centre for Development Studies, Working Paper No. 200 Centre-State Resource Transfers Table No. VI.
Similarly the percentage share of statutory grants in total grants declined in general and reached the level of 22.4 per cent in fourth plan period. Only under annual plans, the percentage share of statutory grants was again high at 36 per cent. During the sixth plan period the share of statutory grants as a percentage of total grants was just 9.4. One can observe the steep fall in the share of statutory grants in total grants.

Regarding the percentage share of loans in non-statutory transfers, it was 81.2 in first plan period and declined to 63.4 during fifth plan period and further to 56.3 during the sixth plan period.

But there is a significant increase in the percentage share of tax transfers in total transfers. It was 24.1 per cent in the first plan period and increased to 30 per cent and 33 per cent respectively during fourth and fifth plan periods. It was 40.6 per cent during sixth plan period. There was no increase in the share of tax transfers as a percentage of total transfers during first three five year plan periods and also in annual plan periods. It increased from fourth plan onwards. In the composition of the devolution of resources from the Union to the States an increase in the statutory part of resources and a decrease in the discretionary part is regarded as desirable.

The percentage share of total grants in total transfers also shows a rising trend. It was 20 per cent during first plan period and rose to 27.4 per cent during sixth plan period.

The percentage share of loans in total transfers which was
$5.6$ during first plan period declined substantially under successive plan periods and it was only $32$ per cent during sixth plan period.

It is obvious from this table that though the percentage share of grants in total transfers increased in successive plan periods, percentage share of statutory grants in total grants is very low. This shows the relative unimportance of statutory grants in the central transfers during plan periods - a trend which does not appear to be healthy.

Having discussed the purpose, principles and the flow of grants-in-aid to states, in general, let us now examine the transfer of grants-in-aid to Andhra Pradesh State Government in detail.

**Grants-in-aid to Andhra Pradesh:**

Since Andhra Pradesh was formed on 1-11-1956, the discussion relating to grants-in-aid (under Article 275) to the government of Andhra Pradesh starts with the recommendations of the second Finance Commission. The commission recommended a grant-in-aid of \(\text{Rs} 4\) crores per annum for meeting the special problem arising out of reorganisation.\(^{10}\)

The grants-in-aid recommended by the other Commissions were as follows:

- **Third Finance Commission**: \(\text{Rs} 28.12\) crores a year (for 4 years 1962-66)
- **Fourth Finance Commission**: \(7.22\) crores a year 1966-69
- **Fifth Finance Commission**: 65.01 crores for 5 years (1969-70 to 1973-74)
- **Sixth Finance Commission**: \(205.75\) crores a year 1974-79

Considering the State of Andhra Pradesh as surplus state, seventh Finance Commission did not recommend grants-in-aid. It allocated Rs.19.60 crores for five years for upgradation of standards of administration in non-development sectors and services. The eighth Finance Commission allocated Rs.80.49 crores for upgradation of standards of administrative services. To meet the margin money requirements of Andhra Pradesh, the eighth Finance Commission recommended a sum of Rs.61.25 crores for five years. About ten days prior to the submission of the eighth Finance Commission report, to the President, Union Finance Minister made an announcement in the Parliament that three instalments of D.A. which had already become due up to 1st Nov. 1963 were being released to the Central government employees. This has resulted in a corresponding rise in the state's expenditure. So the eighth Finance Commission recommended that in addition to the grants to cover the revenue gap, additional grants-in-aid may be given to the states to cover additional deficits arising out of the payment of additional D.A. Thus, the total amount of grants-in-aid paid to Andhra Pradesh government for 1984-89 was Rs.141.74 crores.

The grants-in-aid of revenue to Andhra Pradesh in

1957-58 was Rs.8.21 crores
in 1967-68 was Rs.29.90 crores and
in 1977-78 was Rs.143.48 crores
The grants-in-aid of revenue of Andhra Pradesh increased nearly by 21.5 times over a period of 21 years. Grants-in-aid to Andhra Pradesh in 1964-65 amounted to Rs.300.27 crores. Over a period of 20 years, it increased nearly 37 times. From the data given in table 4.6 it is clear that the grants-in-aid from the centre to Andhra Pradesh has been progressively increasing in absolute terms.

The percentage share of grants-in-aid in total revenue of Andhra Pradesh (Table 4.8) during

1987-88 was 13.17 per cent
1987-88 was 16.23 per cent
1977-78 was 17.68 per cent

After 1978-79 the percentage share of grants-in-aid started declining. It decreased to

13.84 in 1983-84 and
13.09 in 1984-85.

It may be noted that though the percentage share of grants-in-aid of revenue in the total revenue of Andhra Pradesh increased between 1957-58 to 77-78 the increase was not significant or sharp. On the other hand, it started declining since 1979-80.

When we calculate the share of grants-in-aid of revenue of Andhra Pradesh (Table 4.10) as a percentage share of devolved
taxes of Andhra Pradesh, it was

81.45 in 1957-58
90.44 in 1967-68
98.37 in 1977-78 and
121.74 in 1978-79

But this increase did not continue. It declined in succeeding years and it was only 66.96 per cent during 1984-85.

During 1957-59 the percentage share of grants-in-aid to total revenue of Andhra Pradesh was 11.79 whereas it was 10.05 per cent in the case of all states (Table 4.12). In 1964-66 the corresponding share was 16.57 per cent, in the case of Andhra Pradesh and 17.21 in the case of all states. The share of grants-in-aid of revenue of Andhra Pradesh as a percentage of total revenue of Andhra Pradesh was 13.77 while it was 16.72 per cent in the case of all states during 1982-84. This reveals that the grants-in-aid of revenue under Article 275 allocated to Andhra Pradesh government is less than that in the all states model. The share of Andhra Pradesh was higher than that of 'all states' during 1957-59.

Average of grants-in-aid to the state of Andhra Pradesh as a percentage of aggregate grants to all states during first plan period was 8.90 (Table 4.7). It declined in subsequent plan periods. During the fifth plan period (1974-79 it was 7.75 and in 1979-84 it was only 6.95.
We may now examine the position of Grants-in-aid under the recommendations of the eighth Finance Commission.

A noteworthy point is that the Government of India decided to implement the recommendations of the eighth Finance Commission (contained in the final report) only for a period of four years i.e. 1985-89 instead of five years (1984-89). For 1984-85 financial year, the Union government decided to continue with the recommendations of the Finance Commission contained in the Interim Report. The reasons for this as stated by Government of India are:11 As almost four months of the current year are over and the budget and annual plans for this year are already in operation, it will cause undue disruption in the economy, if the budgets and plans for the remaining part of the current year were to be changed now. In particular, any change in the formula for devolution of central taxes and duties in mid-year is not considered feasible as it would involve reduction in shares of different states.

The estimated reduction in the quantum of resources transferred to the states because of the non-implementation of the recommendations of the eighth Finance Commission from 1-4-84 is shown in table 5.2. under different heads.

TABLE 5.3

RESOURCE TRANSFERS TO ALL STATES

(k. in crores)

<table>
<thead>
<tr>
<th></th>
<th>Transfers recommended by eighth Finance Commission's</th>
<th>Likely transfers as a result of Govt.'s decision</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>Taxes and duties</td>
<td>35,683</td>
<td>35,167</td>
<td>516</td>
</tr>
<tr>
<td>Article 275 grants</td>
<td>3,769</td>
<td>3,427</td>
<td>342</td>
</tr>
<tr>
<td>Debt relief</td>
<td>2,285</td>
<td>1,828</td>
<td>457</td>
</tr>
<tr>
<td></td>
<td>Grand total: 41,737</td>
<td>40,422</td>
<td>1,315</td>
</tr>
</tbody>
</table>


As against the estimated loss of Rs. 1,315 crores for all states put together, loss to Andhra Pradesh may now be examined. The Eighth Finance Commission recommended an amount of Rs. 3,101.16 crores to Andhra Pradesh for 1984-89. But the likely transfer of resources during 1985-89 will be Rs. 3,003.08 crores. Thus the loss to Andhra Pradesh is placed at Rs. 98 crores i.e. 7.45 per cent of loss to all the states put together. The details are shown in Table 5.3.
## Table 5.1

**Resource Transfers to Andhra Pradesh**

(m. in crores)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Taxes and duties</td>
<td>1502.89</td>
<td>2754.79</td>
<td>2715.13</td>
<td>39.66</td>
</tr>
<tr>
<td>Article 275 grants</td>
<td>19.60</td>
<td>141.74</td>
<td>124.24</td>
<td>17.50</td>
</tr>
<tr>
<td></td>
<td></td>
<td>1522.49</td>
<td>2896.52</td>
<td>2839.37</td>
</tr>
<tr>
<td>Debt relief</td>
<td>135.63</td>
<td>204.64</td>
<td>163.71</td>
<td>40.93</td>
</tr>
<tr>
<td>Grand total</td>
<td>1658.17</td>
<td>3101.16</td>
<td>3003.08</td>
<td>98.08</td>
</tr>
</tbody>
</table>

It may be seen from the table that the estimated loss under the 275 grants is placed at Rs. 17.50 crores.

It is to be noted that though grants-in-aid (Article 275) to Andhra Pradesh as a percentage of states' total revenue, tax revenue and devolved taxes of Andhra Pradesh increased between 1957-58 to 1977-78 it declined in succeeding years. Further the non-implementation of the recommendations of eighth Finance Commission for 1984-85 also reduced the share of Andhra Pradesh along with other states, in the resource transfers from the Union government.

**Loans from the Centre:**

In a federation, the resources and responsibilities are normally divided between the federal and state governments in such a way that each of them employs the resources in the best possible manner. The power to raise loan is part of the fiscal autonomy. In most of the federations, the constitutions clearly laid down the borrowing powers of the federal and state governments.

In U.S.A., the borrowing powers of the states are restricted by the state constitutions. In Australia Loans Commission was established to manage the total external borrowings for the whole of Australia. Loans commission had its origin because of very great over borrowing by some of the states which bankrupted themselves.
Borrowings in India

The Indian constitution closely followed the Government of India Act, 1935, with regard to borrowing powers of Union and the State governments. The G.O.I Act of 1935 restricted to certain extent the provincial powers of borrowing. The provincial governments could borrow upon the security of their revenues. But it has no power to raise loan outside the country without the consent of the Centre.

The constitution of India in a similar way, confers the borrowing power on both Union government and State governments. Under Article 292, the Union government borrows on the security of consolidated fund of India. Indian constitution gave the Union government the power of borrowing in India and abroad. Article 293 which speaks of borrowing power of the State governments restricts its power from raising foreign loans. A State also cannot raise a public loan without the consent of the Union government if there is still outstanding any part of loan which has been advanced to it by the Government of India or in respect of which guarantee has been given by the Government of India.

For the expansion of public functions and for achieving better social and economic goals, government has to raise loans. The State governments get about one-third of the total resource
transfers through the devolution of tax proceeds. However, the size of the plan and non-plan budgetary requirements decide the fiscal need of a state. So to cover the fiscal gap remaining after the inclusion of devolution of taxes and grants to its resources, the States raise loans from the Public as well as from the Union government.

**Union Loans**

As far as Central loans are concerned the States' indebtedness to the Centre for financing development projects has been accumulating year after year. The servicing of loans and repayment are lagging behind fresh obligations. It is increasingly becoming difficult to manage the magnitude of indebtedness.

The capital projects financed from loans can become self-liquidating provided they are income earning and proper charging policies are pursued for recovering the costs from the beneficiaries. The pay off may begin sooner or later depending on the gestation period. With suitable scheduling or repayment, debt management does not pose any difficulties.

Where no direct returns occur, loan financing creates problems...

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of repayment as well as servicing resulting in a great strain on States' resources.\textsuperscript{14} The borrowings of the State governments from the Union government not only for capital projects but also for semi-productive and unproductive projects leads to greater and greater dependence of the States on the Central government.

The State governments raise loans from the Centre for both 'Plan' and 'non-plan' purposes. The State governments obtain non-plan loans for purposes such as for relief and rehabilitation, for purchase of fertilisers, for modernising the services of police force, for the construction of houses for their employees etc. These non-plan loans are determined by the Union government. The terms and conditions differ from loan to loan and from State to State. These loans are largely given at the discretion of the Union government. The States raise various categories of loans from the Union government in respect of which repayments have to be made by the State governments.\textsuperscript{15} They are

1. Ways and means advances
2. Short term loans for purchase and distribution of fertilisers.
3. Short-term loans for pesticides and seeds

\textsuperscript{14}\textit{Ibid.}, p. 113.
\textsuperscript{15}\textit{Finance Commission Report, 1973}, p. 76.
4. Loans against share of small savings and
5. Other loans

Ways and means advances are intended to enable the State governments to meet temporary difficulties due to uneven flow of receipts and disbursements and as such they cannot be used for financing long term projects.

Short-term loans are advanced for the purchase and distribution of fertilisers, pesticides and seeds which are generally repayable within six months.

Loans against the share of small savings are given to the States on the basis of net collections within the State.

However, the repayments of all other loans—loans for clearance of over drafts have to be treated as legitimate non-plan capital liability of the State governments. The liability for repayment of these loans is largely responsible for the non-plan capital gap of these States. All fresh loan receipts from the Government of India for State plan schemes or centrally sponsored schemes have to be excluded in determining the non-plan capital gap for these are intended for financing the plan.\(^{16}\)

\(^{16}\)Ibid.
The States borrow money from other sources also. For example, the State governments raise loans from the autonomous bodies like National Co-operative Development Corporation, Life Insurance Corporation and Reserve Bank of India.

**TABLE - 5.4.**

TRANSFER OF RESOURCES FROM THE CENTRAL TO THE STATES

<table>
<thead>
<tr>
<th>Plan period</th>
<th>Share in Taxes</th>
<th>Grants</th>
<th>Loans</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1951-56</td>
<td>344</td>
<td>288</td>
<td>799</td>
<td>1431</td>
</tr>
<tr>
<td></td>
<td>(24.04)</td>
<td>(20.13)</td>
<td>(55.03)</td>
<td>(100)</td>
</tr>
<tr>
<td>1956-61</td>
<td>668</td>
<td>709</td>
<td>1411</td>
<td>2868</td>
</tr>
<tr>
<td></td>
<td>(23.39)</td>
<td>(27.51)</td>
<td>(49.20)</td>
<td>(100)</td>
</tr>
<tr>
<td>1961-66</td>
<td>1196</td>
<td>1304</td>
<td>3100</td>
<td>5600</td>
</tr>
<tr>
<td></td>
<td>(21.36)</td>
<td>(23.28)</td>
<td>(55.36)</td>
<td>(100)</td>
</tr>
<tr>
<td>1966-69</td>
<td>1282</td>
<td>1389</td>
<td>2676</td>
<td>5347</td>
</tr>
<tr>
<td></td>
<td>(23.97)</td>
<td>(25.98)</td>
<td>(50.05)</td>
<td>(100)</td>
</tr>
<tr>
<td>1969-74</td>
<td>4562</td>
<td>3831</td>
<td>6708</td>
<td>15101</td>
</tr>
<tr>
<td></td>
<td>(30.21)</td>
<td>(25.37)</td>
<td>(44.42)</td>
<td>(100)</td>
</tr>
<tr>
<td>1974-79</td>
<td>8266</td>
<td>8056</td>
<td>2956</td>
<td>25278</td>
</tr>
<tr>
<td></td>
<td>(32.7)</td>
<td>(31.87)</td>
<td>(35.43)</td>
<td>(100)</td>
</tr>
<tr>
<td>1979-84</td>
<td>21304</td>
<td>15060</td>
<td>18258</td>
<td>54622</td>
</tr>
<tr>
<td></td>
<td>(39.0)</td>
<td>(27.57)</td>
<td>(33.4)</td>
<td>(100)</td>
</tr>
</tbody>
</table>

Note: Figures in brackets indicate percentages to the total.

Union loans to the States increased progressively in absolute terms. Loans during first plan period amounted to Rs. 799 crores and during third plan period they stood at Rs. 3,100 crores. Over a period of fifteen years, the increase of Union loans from the Centre was four fold. During fourth plan period these loans increased to Rs. 6708 crores and during the period of 23 years central loans to the States increased nearly 8.4 times. During 1979-84, Central loans to the States aggregated to 10,258 crores.

Total transfer of resources from the Centre during the first plan period was Rs.1431 crores of which union loans amounted to Rs.799 crores. Union loans covered 55.83 per cent of the total transfers whereas the shared taxes and grants occupy second and third positions respectively. In successive plan periods also union loans formed significant portion of the total transfers.

During fourth plan period, though the percentage share of loans in total transfers decreased to 44 per cent, the percentage share of shared taxes and grants in total transfers increased to 30 and 23 respectively. Loans from the Centre occupied the first place followed by shared taxes and grants. It is clear from table 5.4 that loans are given by the Union to the State governments in significant proportions to meet
their requirements. Though Union loans decreased to 33 per cent during 1979-84, they covers one third of the total transfers.

Continuous increase in the indebtedness of the States to the Centre reflects the assistance provided by the Centre to the States year after year for financing not only their plan outlays but also for meeting the non-plan needs such as those arising from relief expenditure on natural calamities.¹⁷

The increasing importance of central loans and the problem of the states regarding the servicing of their debts to the centre are inter connected. The lower the proportion of loans in central transfers, the smaller would be the indebtedness. The sixth Finance Commission for the first time, was asked to suggest changes in terms of central loans. The state government urged for broad distinction between productive and unproductive debt on the basis of which a significant percentage of the debt should be written off.¹⁸

Writing off all outstanding debts will not be a correct solution of the problem of this will mean a corresponding reduction in the resources available to the centre for financing the national plan and ultimately all the states particularly.


¹⁸Ibid.
financially weaker states will be affected by this policy. The sixth Finance Commission argued that the recoveries of old loans enable the centre to lend the amount to states again.\(^{19}\)

However, several proposals were made for the revision of the terms of central loans to reduce the repayment obligations of the states during fifth plan period to the extent of Rs.1,970 crores.\(^{20}\)

The seventh Finance Commission was asked to suggest "appropriate measures" to deal with the non-plan capital gap of the states in the period covered by it (1979-80 to 83-84). The seventh Finance Commission worked out the capital out-lay and loans and advances made by the state governments into three broad categories - unproductive, semi-productive and productive. It appeared logical, to the seventh Finance Commission, that central loans applied to unproductive purpose should not be expected to be repaid for the state government can not get any return even to meet their interest liabilities.\(^{21}\) Therefore, there should be only repayment of capital. The amount involved out of the total outstanding of Rs.13,462.84 crores for all states at the end of 1978-79 was Rs.9,942.82 crores.

\(^{19}\)Ibid. p. 85.

\(^{20}\)Ibid. p. 95

In regard to the balance of central loans outstanding at the end of 1978-79, the seventh Finance Commission considered that repayment of these loans over periods related to the purposes for which they have been used. The seventh Finance Commission felt it reasonable that the outstanding loans attributable to semi-productive purposes should be repayable in thirty years from 1979-80 and the balance of outstanding loans attributable to productive purposes should be repayable over a period of fifteen years from 1979-80.

On the whole the repayment liability of the state governments to the centre was reduced by Rs.2155.80 crores as estimated by seventh Finance Commission, comprising Rs.388.14 crores on account of small savings and Rs.1767.66 due to write off as well as conversions into thirty-year loans and fifteen-year loans.

The eighth Finance Commission was asked to "suggest changes in the existing terms of repayment" of central loans and to suggest appropriate measures to deal with the non-plan capital gap as a whole.

Several state governments suggested, before the eighth Finance Commission, for reduction of their outstanding debts and in particular their repayment burden. They also have made suggestions regarding the interest rate.

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22Ibid., p. 88.
For the purpose of providing debt relief non-plan capital gap has been computed. Repayment of over drafts, loans and small savings loans were kept outside the scheme of debt relief. The eighth Finance Commission did not recommend any relief in respect of over draft loans given to the states in 1982-83 and 1983-84. The eighth Finance Commission recommended no relief in respect of small savings loans, except that in 1984-85 no repayment shall be made.23 The estimated relief to States in the five year period 1984-89 including the writing off of repayment of 405.29 crores was Rs.2,265-39 crores.

Over Drafts:

The major, possible factors, behind the States' deficits are24 as follows:

1. The practice of the Finance Commissions to cover the non-plan revenue gaps by Article 275 grants without providing adequately against any inflation during the award period. As a result, the real value of grants get usually reduced and a larger gap originates even before a Finance Commission's award starts getting implemented.

2. The existence of large non-plan capital gaps caused principally by the heavy debt burdens which the States have


accumulated over the years. The consequences of denigrating centre-State relations into a debtor-creditor relationship are increasingly being reflected in these gaps.

Loans granted for filling non-plan gap are given by the Union to the States. These loans are outside the purview of the recommendations of the Finance Commission and Planning Commission.

Under an agreement between the State governments and Reserve Bank of India, the State governments have to keep certain minimum cash balances with the Reserve Bank of India against which Reserve Bank of India makes advances to the State governments which are repayable within a period of three months from the date of advance. But in actual practice the restrictions viz. time limit and limit of advances to each State government are ignored. Though the Reserve Bank of India issues a notice to the State governments to clear their over drafts within a period of three months, the States clear their overdrafts only at the end of June, the financial year of Reserve Bank of India.

To clear these overdrafts, Union government advances loans to the States. Increase in the overdraft is the result of continuous resort to overdrafts largely because of unplanned expenditure of state governments. The practice to run into overdraft is a unhealthy in a federal set up and is a sign of financial indiscipline. The eighth Finance Commission did not suggest
any change in the terms of repayments of over drafts loans and have kept such loans outside the scheme of debt relief because any modifications in the terms of repayments of such loans in favour of the States would amount to condoning laxity in fiscal management.  

In 1985, the Union government announced its policy to put an end to this problem of overdraft by converting the overdrafts of the State governments into medium term loans and stop the overdraft facility further to the State governments. The State governments responded to the call of Union government for financial discipline and reduction of overdraft. The total amount outstanding had come down from ₹1008 crores on 28th January 1985 to ₹912 crores on 26th June 1985.

**Union loans to Andhra Pradesh**

The government of Andhra Pradesh received Union loans which amounted to ₹27.5 crores in 1957-58. The loans increased to ₹78.9 crores in 1967-68 and to ₹160.3 crores in 1977-78.

Loans from the Centre further rose to ₹309 crores during 1984-85. Over a period of twenty-eight years, union loans to Andhra Pradesh government increased by 11 times. This is shown...
The net borrowings of Andhra Pradesh after the repayment of loans during 1957-58 was 15.21 crores. During 1967-68, Andhra Pradesh government raised loans which amounted to 1.78.1 crores but repaid only half of the amount i.e., 1.39.3 crores. The net borrowings of Andhra Pradesh during 1983-84 was 1.154.51 crores and in 84-85 was 1.206.38 crores.

Increasing trend in the net borrowings shows that the repayment of government of Andhra Pradesh is much less than the loans received from the Centre. Net borrowing as a percentage of repayment amounted to 199.90 in 1984-85.

The government of Andhra Pradesh proposed to the Finance Commission that loans and advances from the Centre should be consolidated by the eighth Finance Commission and that those not consolidated, but outstanding as on 31-1-84 should be written off. It also proposed that no relief may be provided on overdraft loans and that all other loans given after 1978-89 be consolidated into one loan repayable over 30 years. Several State governments have made suggestions in regard to interest rates. Andhra Pradesh proposed that the States' share of small savings collections should be given as grants and not as loan.27

### Table 5.5

**Loans from the Centre**

<table>
<thead>
<tr>
<th>Year</th>
<th>Loans received</th>
<th>Loans repaid</th>
<th>Net Borrowings</th>
<th>Amount outstanding at the end of the year</th>
</tr>
</thead>
<tbody>
<tr>
<td>1957-58</td>
<td>27.54</td>
<td>12.33</td>
<td>15.21</td>
<td>121.86</td>
</tr>
<tr>
<td>1958-59</td>
<td>23.67</td>
<td>6.22</td>
<td>17.45</td>
<td>139.31</td>
</tr>
<tr>
<td>1959-60</td>
<td>19.14</td>
<td>15.67</td>
<td>3.47</td>
<td>142.78</td>
</tr>
<tr>
<td>1960-61</td>
<td>35.57</td>
<td>20.12</td>
<td>15.45</td>
<td>156.23</td>
</tr>
<tr>
<td>1961-62</td>
<td>57.61</td>
<td>28.84</td>
<td>28.77</td>
<td>187.00</td>
</tr>
<tr>
<td>1962-63</td>
<td>57.36</td>
<td>22.06</td>
<td>35.30</td>
<td>222.30</td>
</tr>
<tr>
<td>1963-64</td>
<td>61.66</td>
<td>25.53</td>
<td>36.13</td>
<td>256.43</td>
</tr>
<tr>
<td>1964-65</td>
<td>53.33</td>
<td>26.49</td>
<td>24.84</td>
<td>283.27</td>
</tr>
<tr>
<td>1965-66</td>
<td>90.82</td>
<td>40.56</td>
<td>50.26</td>
<td>333.53</td>
</tr>
<tr>
<td>1966-67</td>
<td>155.26</td>
<td>36.93</td>
<td>118.33</td>
<td>451.86</td>
</tr>
<tr>
<td>1967-68</td>
<td>78.91</td>
<td>39.33</td>
<td>39.58</td>
<td>491.44</td>
</tr>
<tr>
<td>1968-69</td>
<td>65.29</td>
<td>62.94</td>
<td>2.35</td>
<td>493.79</td>
</tr>
<tr>
<td>1969-70</td>
<td>109.12</td>
<td>67.69</td>
<td>41.43</td>
<td>535.22</td>
</tr>
<tr>
<td>1970-71</td>
<td>106.96</td>
<td>95.93</td>
<td>11.03</td>
<td>546.24</td>
</tr>
<tr>
<td>1971-72</td>
<td>92.60</td>
<td>67.25</td>
<td>25.35</td>
<td>571.79</td>
</tr>
<tr>
<td>1972-73</td>
<td>183.26</td>
<td>65.03</td>
<td>118.23</td>
<td>690.02</td>
</tr>
<tr>
<td>1973-74</td>
<td>77.50</td>
<td>75.70</td>
<td>1.80</td>
<td>691.62</td>
</tr>
<tr>
<td>1974-75</td>
<td>70.40</td>
<td>27.19</td>
<td>43.21</td>
<td>735.03</td>
</tr>
<tr>
<td>1975-76</td>
<td>85.32</td>
<td>49.97</td>
<td>35.35</td>
<td>770.38</td>
</tr>
<tr>
<td>1976-77</td>
<td>92.20</td>
<td>44.73</td>
<td>47.47</td>
<td>817.85</td>
</tr>
<tr>
<td>1977-78</td>
<td>160.34</td>
<td>54.62</td>
<td>105.72</td>
<td>923.57</td>
</tr>
<tr>
<td>1978-79</td>
<td>209.46</td>
<td>59.60</td>
<td>150.46</td>
<td>1074.03</td>
</tr>
<tr>
<td>1979-80</td>
<td>196.01</td>
<td>54.58</td>
<td>141.43</td>
<td>1215.46</td>
</tr>
<tr>
<td>1980-81</td>
<td>213.54</td>
<td>66.73</td>
<td>144.81</td>
<td>1359.93</td>
</tr>
<tr>
<td>1981-82</td>
<td>189.90</td>
<td>79.46</td>
<td>110.44</td>
<td>1470.39</td>
</tr>
<tr>
<td>1982-83</td>
<td>248.70</td>
<td>80.58</td>
<td>168.12</td>
<td>1638.51</td>
</tr>
<tr>
<td>1983-84</td>
<td>246.42</td>
<td>91.98</td>
<td>154.51</td>
<td>1793.02</td>
</tr>
<tr>
<td>1984-85</td>
<td>309.62</td>
<td>103.24</td>
<td>206.38</td>
<td>1999.40</td>
</tr>
</tbody>
</table>

Source: A.P. Budget in Brief.

1964-65 to 1972-73 - A.P. Budget in Brief 1974-75
The loans consolidated and rescheduled by the eighth Finance Commission carry the rate of interest as shown below:

<table>
<thead>
<tr>
<th>Category of loans</th>
<th>Period of repayment</th>
<th>Rate of interest</th>
</tr>
</thead>
<tbody>
<tr>
<td>a) Pre 1979 loans consolidated and rescheduled</td>
<td>25 &amp; 30 years</td>
<td>4.75</td>
</tr>
<tr>
<td>b) 1979-84 loans consolidated and rescheduled</td>
<td>15 years</td>
<td>6.00</td>
</tr>
<tr>
<td></td>
<td>20 years</td>
<td>6.25</td>
</tr>
<tr>
<td></td>
<td>25 years</td>
<td>6.50</td>
</tr>
<tr>
<td></td>
<td>30 years</td>
<td>6.75</td>
</tr>
</tbody>
</table>

The estimated relief to Andhra Pradesh in the five year period 1984-89 on the basis of rescheduling is ₹204.64 crores and including written off amount is ₹405.20 crores.

An examination of principles and purposes of grants-in-aid and loans from the Union government to States in general and to Andhra Pradesh in particular helps us to draw broad conclusions relating to these transfers.

Generally, grants-in-aid of revenue under Article 275, a statutory transfer, is preferred to discretionary grants. Though the share of total grants in total transfers increased in the successive plan periods, the relative share of statutory grants in total transfers decreased significantly from 35.3 per cent in the first plan period to 9.4 per cent in sixth plan period - an undesirable and unhealthy trend.

The seventh Finance Commission recommended grants-in-aid only to eight states to cover fiscal gap remaining even after the
devolution of the taxes and duties. For the distribution of the taxes and duties, Article 275 grants the eighth Finance Commission classified the States into 3 categories (1) States with surplus revenue before the devolution of taxes and duties (2) States with surplus revenue after the devolution of resources and (3) States which show deficit, even after devolution of resources, and cannot meet the requirements of upgradation without further assistance. The eighth Finance Commission recommended no grants-in-aid to the States which come under the first two categories. It recommended grants-in-aid to the deficit States — the third category.

Though the relative share of grants-in-aid in the sum of taxes transferred to Andhra Pradesh increased between 1957-58 and 1978-79,

<table>
<thead>
<tr>
<th>Year</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>1957-58</td>
<td>81.45</td>
</tr>
<tr>
<td>1967-68</td>
<td>90.44</td>
</tr>
<tr>
<td>1977-78</td>
<td>98.37</td>
</tr>
<tr>
<td>1978-79</td>
<td>121.74</td>
</tr>
</tbody>
</table>

It declined in succeeding years and it was only 66.96 or 67 percent in 1984-85.

The percentage share of Grants-in-aid in total revenue of Andhra Pradesh is less than that of grants-in-aid of all States in total revenue of all States (Table 4.12).
Total devolutions (taxes+grants) as a percentage of total revenue of Andhra Pradesh is low (table 4.12) compared with the corresponding percentage in the total revenue of all States in Indian Union. Though the share of total devolutions from the Centre declined to all States, the decrease in the case of Andhra Pradesh was more than that for all States.

To meet the growing requirements of money it is inevitable for the States to borrow from the Union government as well as from the public. In the first three plan periods central loans covered half of the total transfers. In the annual plan periods also the proportion of loans to total transfers constituted 50 per cent. From the fourth plan period onwards it started declining and it covered one-third of the total transfers during fifth and sixth plan periods.

The seventh Finance Commission took a right step by working out the purpose-wise outstanding loans of the States - unproductive, a semi-productive and productive purposes. The estimated reduction in the repayment liability of the State of Andhra Pradesh to the Centre was 135.63 crores as per the recommendation of the seventh Finance Commission. The estimated relief for the five year period 1984-89, as recommended by the eighth Finance Commissions is Rs.405.20 crores.
Non implementation of the recommendations of the eighth Finance Commission with effect from 1-4-84 is estimated to result in a loss to Andhra Pradesh under 275 grants of ₹ 17.30 crores. Similarly the loss in respect of debt relief to Andhra Pradesh because of the one year lag in the implementation of recommendations is ₹ 40.93 crores.