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BORROWING POWERS OF THE STATES IN

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BORROWING POWERS OF THE STATES IN INDIA

3-1. INTRODUCTION:

India is a union of twenty-two states,¹ besides the nine union territories² that are administered by the Government of India. India had a unitary constitution till 1919. Federalism had its birth with the introduction of Montague-Chelmsford Reforms of 1920. Steps towards federalism gained momentum as a result of the inauguration of provincial autonomy on April 1, 1937. With the adoption of the Indian constitution on January 26, 1950, the process of federalism was completed. Since the Indian federation was born out of devolution of responsibilities and power from the centre to the states, the centre is relatively stronger, which has made some people to think that the Indian Constitution has the germs of a unitary constitution.³

The division of powers and functions between the two layers of Government is an essential feature of federalism.⁴ The division of functions and resources between the union and state Government in India is based on the written provisions contained in the constitution. This division is in accordance with efficiency and scientific considerations.⁵ When separate resources are assigned to the federal and the state Governments, they must both have the power to borrow on the security of the resources. Borrowing power is a sign of fiscal autonomy and in most federations it is exercised by both the layers of the Government.

In most of the federations, their constitutions have made provisions for intergovernmental borrowings. These constitutional provisions mostly empower the national governments to lend loans to the state and local governments with certain safeguards and restrictions mainly intended to protect the credit worthiness of the borrowing governments. Thus, intergovernmental debt operations are an outcome of the constitutional provision and such provision has given an opportunity for the State Governments to obtain required funds at reasonable terms without facing the vagaries of the financial market.

In India, ^{the} former British Indian Provinces obtained the power to borrow from any source only in 1921. As the country was having a unitary form of administration prior to 1919, the question of borrowing powers of the then administrative provinces did not arise. However, the former princely states enjoyed the power to borrow within their respective territories. But they were required to obtain the approval of the Governor-General-in-Council for borrowing outside their territories.

3.2. GOI ACT 1919 :

The Government of India Act of 1919 conferred on the British Indian Provinces under the Local Government's Borrowing Rules the power to borrow inside as well as outside the country on the security of the revenues assigned to them. This ACT

empowered the former provinces to borrow from the general public, financial institutions and from the then Government of India, within the country with the approval of the Governor-General-in Council, and from outside the country with the consent of the Secretary of State for India. But these borrowing powers are not utilised by the former provinces in any extensive way. 'During the period April 1, 1921 to March 31, 1937, only three provincial Governments, namely those of Bombay, U.P. (United Provinces) and Punjab, raised loans in the internal market!'⁶

3.3. GOI ACT 1935 :

"The GOI Act 1935 stands like a mile-stone on the road to federalism. This Act is of special significance. It is on the pattern of this Act that the allocation of the sources of revenue between the Union and the states has been envisaged in the constitution."⁷ Under section 163 of the Government of India Act, 1935, the Provincial Governments could borrow upon the security of their revenues, (continued the right of former provinces to borrow)." They were empowered to borrow inside as well as outside of the country. However, just as in the case of the local Governments' borrowing Rules under the Government of India Act of 1919, clause (3) of Section 163 of the Government of India Act of 1935 imposed certain restrictions on the powers of the former provinces to borrow in the following way :

' A province may not, without the consent of the Federation, borrow outside India, nor without the consent raise any loan if there is still outstanding any part of a loan made to the province by the Federation or by the Governor-General-in Council'⁸

* And the act also conferred the right to borrow short term loans from the Reserve Bank of India in the form of ways and means advances by selling their Treasury Bills.⁹ On the inauguration of provincial Autonomy, it was decided that balances of an intrinsically local nature, or balance definitely associated with any function which was assigned to the provinces, should be decentralized. A part of these balances was credited to the Provincial Governments and the remaining amounts were adjusted against the outstanding loan advances made previously by the Central Government. On the recommendation of Sir Otto Niemeyer (Niemeyer Award); the outstanding debts to the Central Government, in the case of certain provinces were wholly or partly cancelled as a measure of special financial assistance to them.¹⁰ The remaining debts were consolidated and were repayable to the Government of India in the form of semi-annual equated payments of interest and principal within a period of forty-five years. In future, the provinces could meet the short term requirements either by ways and means advances from the Reserve Bank of India on the issue of Treasury Bills. The provinces commenced borrowing in this form in 1938-39. They have

sometimes taken ways and means from advances from the Central Government also.

3.4. CONSTITUTIONAL PROVISIONS REGARDING STATE BORROWING :

In the Indian constitution, borrowing provisions are contained in Articles 292 and 293. Article 292 empowers the Union Government to borrow (and to give guarantees) upon the security of the consolidated fund of India within limits fixed by the Parliament. In terms of the provision of Article, 292, " The executive power of the Union extends to borrowing upon the security of the consolidated fund of India within such limits, if any as may, from time to time, be fixed by the Parliament, by law and to the giving of guarantees within such limits, if any, as may be so fixed." "On the contrary, the borrowing powers of the states are, both territorially and otherwise limited."¹¹

The constitution of India has empowered the states under Article 293 (1) to borrow within India on the security of the consolidated funds of the respective states and also to give guarantee to loans raised by their subordinate authorities or authorities created by the state Legislatures. In term of the provisions of the article 293(1), "Subject to the provisions of this article, the executive power of a state extends to borrowing within the territory of India upon the security of the Consolidated Fund of the state within such limits, if any, as may, from time to

time, be fixed by the legislature of such a state, by law and to the giving of guarantees within such limits, of any, as may be so fixed." According to these constitutional powers, the state governments can borrow only within the country from the general public financial institutions, Reserve Bank of India and from the Union government."¹²

Article 293(2) also provides that the Government of India may give loans to the states or give guarantees for state loans.¹³

In terms of the provisions of Article 293(3)," A State may not, without the consent of the Government of India, raise any loan if there is still outstanding any part of a loan which has been made to state by the Government of India or by its predecessor Government, or in respect of which a guarantee has been given by the Government of India or by its predecessor Government."

And article 293(4) represents," A consent under clause(3) may be granted subject to such conditions, if any, as the Government of India may think fit to impose."

It means, a state cannot borrow without the consent of the Government of India if it owes a debt to that Government or there is an outstanding loan for which the Government of India

has given a guarantee." The states are prohibited from raising loans in foreign countries as ' foreign loans ' is a subject over which the Union government has exclusive jurisdiction (Item No. 37, List I of the Seventh Schedule). External loans, moreover, raise a transfer problem which exercises a pressure on foreign payments. Sometimes, they also raise international complications and it is, therefore, a desirable restriction on the power of the states to raise loans."¹⁴ Even if the state governments require foreign loans for developmental purpose, they have got to obtain through the instrumentality of the Union government."¹⁵

Here we have seen that there are constitutional restrictions placed on the states' internal borrowing powers. But it is with a view to avoiding adverse monetary and fiscal effects originating from competitive and also unbridled borrowing powers of the states.

A competition between the union and the state government in borrowing has been avoided by the Reserve Bank of India which manages the public debt operations of the Union as well as the State governments. Besides, all the states have borrowed from the Union government, and therefore, its consent is necessary before they can float loans in the open market. This helps in fixing on order of priority of state borrowings and the timing

of the loans. It also avoids competition which would cause unhealthy movements in the money market to the disadvantage of all.

In respect of borrowing powers of the states in India, G. Thimmaiah concludes that, "the Indian Constitution has empowered the State Governments to borrow from the Union government subject to necessary safeguard. However, it does not specify the purpose for which they can borrow from the Union government nor has it fixed the maximum limit upto which each state can borrow. These are rightly left to the discretion of the Union and the state legislature.

R E F E R E N C E S

1. These are Andhra Pradesh, Assam, Bihar, Gujarat, Haryana, Himachal Pradesh, Jammu & Kashmir, Karnataka, Kerala, Madhya Pradesh, Maharashtra, Manipur, Meghalaya, Nagaland, Orissa, Punjab, Rajasthan, Sikkim, Tamil Nadu, Tripura, Uttar Pradesh and West Bengal.
2. These are Andman & Nicobar Islands, Arunachal Pradesh, Ghandigarh, Dadra & Nagar Haveli, Delhi, Goa, Damman & Diu, Lakshdweep, Mizoram & Pondicherry.
3. Bhargava P.K., Centre-State Resource Transfers in India, The Academic Press, Haryana 1982, PP.1-2.
4. Ibid, P. 4.
5. Ibid, P. 6.
6. Bhargava R.N., The Theory and Working of Union Finance in India, Chaitanya Publishing House, Allahabad 1974, P.188.
7. Sharma J.N., The Union and the States, : A study in Fiscal Federalism, Sterling Publishers (P) Ltd., New Delhi, 1974, P. 31.
8. Thimmaiah G., Burden of Union Loans on the States, Sterling Publishers Pvt. Ltd. New Delhi 1977, P. 10.

9. Ibid.
 10. Sharma J.N., The Union and the States : A study in Fiscal Federalism, P. 34.
 11. Bombwall Raman, Federal Financial Reletions in India, Meenakshi Prakashan, Meerut, P. 35.
 12. Thimmaiah G. Burden of Union Loans on the States, P.10.
 13. Article 293(2) of Indian Constitution : The Government of India may, subject to such conditions, as may be laid down by or under any law made by Parliment, make loans to any State or, so long as any limits fixed under Article 292 are not exceeded, give guarantees in respect of loans raised by any state any sums required for the purpose of making such loans shall be charged on the Consolidated Fund of India.
 14. Lall G.S., Financial Administration in India, H.P.J. Kepor's Publication, Delhi-6, 1969, P. 230.
 15. Thimmaiah G., Burden of Union Loans on the States, P P.10-11.
 16. Ibid, P. 11.
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