

CHAPTER I

INTRODUCTORY

Appointment of the Commission.—The President is required under Article 280(1) of the Constitution to constitute within two years from the commencement of the Constitution and thereafter at the expiration of every fifth year, or at such earlier time as he may consider necessary, a Finance Commission consisting of a Chairman and four Members appointed by him. By an Order dated the 22nd November 1951, the President constituted a Commission consisting of the following Members:—

Chairman

Shri K. C. Neogy.

Members

Shri V. P. Menon.

Shri Justice B. Kaushalendra Rao.

Dr. B. K. Madan.

Shri M. V. Rangachari. Member-Secretary.

The Chairman and Members of the Commission assumed office on the 30th November 1951. Shri V. P. Menon resigned his office as Member of the Commission on the 18th February 1952 and the President appointed Shri V. L. Mehta in his place.

The Chairman and Members of the Commission were appointed for a period of one year ending the 30th November 1952. This period was subsequently extended by one month.

2. Functions of the Commission.—Under Article 280 of the Constitution the Commission are charged with the duty of making recommendations to the President as to—

(a) the distribution between the Union and the States of the net proceeds of taxes which are to be, or may be, divided between them under the provisions of Chapter I of Part XII of the Constitution and the allocation between the States of the respective shares of such proceeds;

(b) the principles which should govern the grants-in-aid of the revenues of the States out of the Consolidated Fund of India;

(c) the continuance or modification of the terms of any agreement entered into by the Government of India with the

Government of any State specified in Part B of the First Schedule under clause (1) of Article 278 or under Article 306; and

- (d) any other matter referred to the Commission by the President in the interests of sound finance.

The provisions of the Constitution bearing on the functions of the Finance Commission are given in Appendix I.

3. Under Article 273(3) read with Article 270(4)(b) and the proviso to Article 275(2) of the Constitution, after a Finance Commission has been constituted, the President has to take into account the recommendations of the Commission before making an Order prescribing grants-in-aid in accordance with the provisions of those articles. A formal request from the President to make recommendations to him in regard to these grants was communicated to us on the 6th April 1952. The communication is reproduced below:

"I am directed to state that the President has been pleased to decide that the Commission should be formally requested to make recommendations to him in regard to—

- (a) the sums to be prescribed by him as grants-in-aid of the revenues of the States of Assam, Bihar, Orissa and West Bengal in lieu of assignment of any share of the net proceeds in each year of the export duty on jute and jute products to these States in accordance with the provisions of article 273 of the Constitution; and
- (b) the States in need of assistance and the sums payable to such States as grants-in-aid of their revenues under the substantive portion of clause (1) of Article 275 of the Constitution.

I am to convey the decision of the President to the Commission for such action as may be necessary."

4. *Powers and Procedure.*—Under sub-clauses (2) and (4) of Article 280 of the Constitution, the qualifications which shall be requisite for appointment as Members of the Commission and the manner in which they shall be selected have to be determined by Parliament by law and the Commission shall have such powers in the performance of their functions as Parliament may by law confer on them. The Finance Commission (Miscellaneous Provisions) Act, 1951, enacted in accordance with these provisions, is reproduced in Appendix II.

5. The Constitution authorises the Commission to determine their procedure, while the Finance Commission (Miscellaneous Provisions) Act, 1951, has conferred on the Commission all the powers of a Civil Court under the Code of Civil Procedure, 1908. The Commission

have also been empowered to require any person to furnish information on such points or matters as, in the opinion of the Commission, may be useful for, or relevant to, any matter under the consideration of the Commission. The powers conferred on the Commission are set out in detail in Section 8 of the Act mentioned earlier.

6. The Commission prescribed their own rules of procedure under the powers vested in them. Among other things, these rules provided that the Commission shall decide from time to time whether their meetings with representatives of State Governments or members of the public should be held in public or private session. We felt that, in the earlier stages of the working of the Commission, at any rate, no rigid formality should be introduced into the procedure and that it would facilitate a full and frank discussion if the meetings were, as far as possible, held in private session. In the latter view the Chief Ministers of the State Governments, whom we generally consulted at the outset of our discussions in the respective States, also concurred. Our discussions with Ministers and other representatives of State and Central Governments were, therefore, held in private session. The discussions with certain Chambers of Commerce in Calcutta and Bombay were held in public.

7. *Provisional Recommendations.*—At a very early stage of our work we had to consider the question of making provisional recommendations to the President in respect of matters in which, after the appointment of a Finance Commission, the Constitution requires him to take into account their recommendations before making an Order. Pending our final recommendations we proposed that in order to avoid dislocation to the finances of the States which were receiving a share of income-tax or grants under one or other of the provisions of the Constitution the position as existing in 1951-52 should be maintained for the year 1952-53 also. We added the condition that any decisions taken on our final recommendations should be given effect to from the year 1952-53. We also recommended that the grants made to some of the States specified in Part A* of the First Schedule to the Constitution, in which certain territories of former Indian States have been merged, on the same basis as some States specified in Part B* of the First Schedule receive grants under sub-clause (1)(b) of Article 278 of the Constitution might also be continued during 1952-53, subject to the condition that they were to be treated as provisional and readjusted in the light of any decisions that might be taken on our final recommendations in regard to financial assistance to these States. Our report, dated the 16th December 1951, containing these recommendations is given in Appendix III. These recommendations were accepted by the President and the formal Order giving effect to them, where necessary, was made by him on the 19th April 1952.

* Herein after referred to as Part A and Part B States, respectively.

8. *Method of Enquiry.*—As part of the preliminary work in connection with the appointment of the Commission the Ministry of Finance addressed the Governments of the Part A States on the 22nd September 1951 requesting them to prepare their case for submission to the Commission on the various matters to be considered by them. After the Commission had been constituted we addressed a similar enquiry to the Governments of the Part B States on the 14th December 1951. At a later stage, we invited the views of the State Governments on the subject of sharing Union excises between the Centre and the States and the distribution of the States' share among them.

9. On the 19th February 1952 we issued a Press Note inviting suggestions of the public in regard to the distribution of the net proceeds of income-tax between the Union and the States and the allocation of the States' share among them and the principles which should govern the grants-in-aid of the revenues of the States out of the Consolidated Fund of India. We requested the State Governments to assist us by giving the widest publicity to this note. We also circulated copies of the note to the editors of important financial and commercial journals, Chambers of Commerce, University Departments of Economics and a number of individuals who, in our view, could help us with their suggestions. The general communications addressed to the States and the Press Note issued are reproduced in Appendix IV. We also give in Appendix V a list of the supplementary points on which we asked for information from the State Governments.

10. We received from the State Governments detailed memoranda giving the information called for and setting out their views on the various matters to be considered by us. These memoranda were of great assistance to us and we were also readily furnished with whatever supplementary information we required. We received from certain Chambers of Commerce and a number of individuals memoranda giving their views, which we have carefully studied and taken into account.

11. We had occasion to avail freely of the facilities in the libraries of the Delhi University, the Indian Council of World Affairs, the Federation of Indian Chambers of Commerce and Industry and the Information Offices of some of the foreign Embassies in New Delhi. We desire to record our sense of appreciation for this help. We also had to obtain information from a number of firms and individuals and their ready response facilitated our task.

12. *Visits to States.*—We visited all the sixteen States between April 1952 and September 1952 and had discussions with the State Governments and their senior officers. We invariably met the Chief Ministers and the Finance Ministers, while in a number of States

we had the opportunity of meeting other Ministers as well. We met the Finance, Development and other Secretaries and senior officers in charge of various departments. The discussions with the State Governments were largely on the basis of the memoranda submitted by them. These had the advantage of enabling us to appreciate their problems and needs more vividly than was possible from a formal document. Some of us also visited a few "scheduled" and border areas in certain States and several institutions connected with development and welfare work. We would like to place on record our deep sense of obligation to the State Governments and their officers for the ready assistance given to us in carrying out our work and for the promptness with which our requests for information were met. The dates of our meetings with the State Governments are given in Appendix VI.

13. We held two public sittings, one in Calcutta on the 13th May 1952 when we met the representatives of the Indian Chamber of Commerce and Industry, the Bharat Chamber of Commerce, the Eastern Chamber of Commerce and the Bengal National Chamber of Commerce, and the other in Bombay on the 6th June 1952 when we met the representatives of the Indian Merchants' Chamber. The representatives of the Bihar Chamber of Commerce met us in New Delhi while the representatives of the Rajasthan Chamber of Commerce and the Jaipur Chamber of Commerce and Industry met us in Jaipur.

14. During the course of our visits to the States we had informal discussions with the Commissioners of Income-Tax concerned. We also met the Accountants General of the States, whom the Comptroller and Auditor General had very kindly asked to assist us.

15. *Discussions with Central Ministries.*—On our return after completing our visits to the States we had discussions with the Secretaries and senior officers of the Central Ministries of Finance, Home Affairs, Education, States, Commerce and Industry, Rehabilitation, Food and Agriculture, Defence, Transport, Works, Housing and Supply and Natural Resources and Scientific Research. We also had a general discussion with the Union Finance Minister. Our thanks are due to the Finance Minister and the officers of the Central Ministries for the ready assistance given to us.

16. *Inadequacy of data.*—While the Central and State Governments made a great deal of material available to us, we consider it our duty to mention that we felt somewhat handicapped by the lack or inadequacy of factual and statistical data in regard to certain matters. This related in particular to national income, the structure and incidence of taxation,—Central, State and Local—the standards and availability of social services in the various States, the distribution of responsibility in certain spheres between the States and local bodies and so on. We realise that this is only part

of the general problem of the want of adequate economic and financial data in this country and that in the case of the more backward of the former Indian States statistics regarding the past may be almost impossible to obtain at the present stage. Later, we are making some recommendations in regard to the collection of current data to be made available to the Finance Commissions in future. In this connection we would recall the suggestions made by the Expert Committee on the Financial Provisions of the Union Constitution that Government should make necessary arrangements without delay for the collection of certain essential data and statistics.

17. *Some special problems of Part B States.*—We should like, at this stage, to mention an important point which arose in our discussions with the Part B States. It was represented by some of them that we should enquire into their grievances in regard to the federal financial integration agreements entered into with them by the Central Government. We carefully considered this point and came to the conclusion that it would not be appropriate for the Commission to deal with the agreements at this stage. Under Articles 278 and 306 of the Constitution, the President is empowered to terminate or modify these agreements only after the expiration of five years from the commencement of the Constitution. Even if we were to make any recommendations affecting the agreements now, the President would not be in a position till then to take action on the recommendations. Further, we feel that for the purpose of the proviso to clause (2) of Article 278 of the Constitution any review of the working of these agreements can be usefully undertaken only after they have been in operation for a reasonable period of time.

18. The agreements with four of the Part B States *viz.*, Saurashtra, Madhya Bharat, Rajasthan and Patiala and East Punjab States Union contain a special provision which is reproduced below:—

“There is need for assistance to the State in connection with the internal integration of its administration and services and particularly in relation to its development in different directions, having regard to the fact that the State is backward in several respects as compared with Part A States. The Government of India will* undertake a systematic enquiry into this problem with a view to rendering financial and technical assistance at the earliest opportunity. It will not be enough if as a result of federal financial integration the State is treated in the matter of grants and other forms of assistance in exactly the same way as Part A States.”

* The word “must” is used in the agreement with Saurashtra.

Our attention was drawn to this provision by the above mentioned ^{States. One of them, namely, Saurashtra, expressed the fear that,} unless this Commission had the necessary power and undertook the responsibility for this enquiry, any recommendations that they might make in regard to that State on the basis of principles applicable to Part A and other Part B States might prejudice the special enquiry on which the State Government relied for financial and technical assistance to remedy the State's backward condition. We explained to the representatives of the State Government, during our preliminary discussions with them, that the Commission had a duty cast upon them by the President to determine which of the States were in need of assistance and make recommendations to him in regard to the sums to be given as grants-in-aid to such States, and that in assessing the needs of the State we would take into account the special problems of Saurashtra including those created by the formation of the Saurashtra Union and the subsequent federal financial integration. This did not, however, seem to satisfy the State Government, and the Chief Minister addressed a letter on the subject to the Chairman, which is reproduced in Appendix VII. We would invite special attention to paragraphs 2, 3 and 5 of that letter. The State Government have expressed the view that it would be against the interests of the State to enter into a discussion of their needs with the Commission unless the enquiry contemplated by the agreement was conceded. Merely because of the caveat entered by the State, we could not refrain from enquiring into its needs as we had to discharge the duty placed upon us by the President to make recommendations to him in regard to all States in need of assistance. We have, therefore, enquired into the needs of Saurashtra, as of all the other States, by standards and criteria which we have applied without discrimination.

19. *Commission's approach to the problem.*—It will be convenient if, before dealing with the individual matters in regard to which we have to make recommendations, we set out briefly our approach to the problem of adjustments between Central and State revenues. The States laid before us an impressive case for increased assistance to meet their growing needs and our discussions with the State Governments have left us in no doubt about the imperative need for a substantial augmentation of the revenues now available to them. We had, however, to take into account not merely the needs of the States but the ability of the Centre as well to assist the States by the transfer of a larger portion of its revenues. It is unnecessary for us to emphasise that the prosperity of the States must rest on the solid foundation of a reasonably strong and financially stable Centre. Nor need the point be laboured that while the States have large and expanding responsibilities for the welfare and development of the people the capacity of the Centre to make additional

resources available is conditioned both by the amount of revenue it can raise and by its own essential needs, which, in the ultimate analysis, are the needs of the country as a whole.

20. The plan of assistance which we have drawn up envisages a substantial transfer of resources from the Centre to the States. We have used the methods both of devolution of revenue and grants-in-aid but have relied substantially on the devolution of revenue for securing this transfer. In doing so we believe we are meeting the general desire of the States themselves. The method has also the advantage of linking the revenues of the States directly with those of the Centre, so that both share in whatever elasticity the revenue that is divided between them possesses. In our proposals for the devolution of revenue we have widened the field of division by recommending the division of a few excises in addition to increasing somewhat the States' share in the divisible pool of income-tax. An increase in the number of divisible taxes also makes it possible to diversify the basis of distribution and achieve a balanced scheme which would benefit all the States. We have recommended general grants-in-aid to such of the States to whom our scheme for the devolution of revenue does not provide adequate resources. We have also recommended grants-in-aid to some of the less developed States to enable them to make some progress in one of the important social services of national interest.

21. We would like to emphasise that our scheme should be considered as an integrated whole. Any modifications in the individual recommendations would affect the balance of the scheme and we have no doubt that this will be borne in mind in taking action on our recommendations.

22. In drawing up the scheme of assistance we have kept three main considerations in view. Firstly, the additional transfer of resources from the Centre must be such as the Centre could bear without undue strain on its resources, taking into account its responsibility for such vital matters as the defence of the country and the stability of its economy. Secondly, the principles for the distribution of revenues between the States and the determination of grants-in-aid must be uniformly applied to all the States. Lastly, the scheme of distribution should attempt to lessen the inequalities between States.

23. During the course of discussions a number of State Governments drew our attention to the finance required for meeting expenditure on capital schemes. We are primarily concerned with the distribution of revenues between the Centre and the States and the determination of grants-in-aid of the revenues of the States, which

have to come from Central revenues. The capital needs both of the Centre and the States have to be met largely from borrowed funds and no devolution of revenue or grants-in-aid which we could suggest would, in present circumstances, be able to satisfy such needs. We are, therefore, making no recommendations in regard to grants for meeting the capital requirements of the States.

24. *Some special points made by States.*—Some of the State Governments also mentioned to us certain handicaps in expanding their revenue under which they laboured as a result of Central policy. Some of them pointed out that under the Central Mining Rules the royalty which they could obtain on minerals exploited in their territories was reduced and thereby, to some extent, they suffered a loss of revenue. The Government of Assam complained against the high price fixed for petrol in the State, although the State was the only producer of motor spirit, and they contended that this high price reduced the margin available to them for the levy of sales taxes on this commodity. The Governments of Orissa and Madhya Pradesh stated that the prices paid to them in the past for the rice supplied by them to the deficit States was much lower than the competitive price that could have been obtained and that to the extent to which this reduced the income of the people of the State it restricted the taxable capacity available to the State Government. The Government of Travancore-Cochin complained that they were not receiving a fair price for the monazite sands supplied by them. We have brought some of these complaints to the notice of the Central Ministers. We do not make any recommendations on these isolated matters as they do not fall within the general scope of our work.

25. *Scheme of the Report.*—The scheme of the Report may now be briefly indicated. In Chapter II we give an account of the evolution of financial relations between the Centre and the units, outlining the changes in the constitutional basis of these relations from time to time as well as the discussions which preceded them. In the third chapter we attempt an analysis of the significant trends in Central and State finances, including outstanding changes in the composition of the revenue and expenditure from one period to another. Thereafter, we deal in separate chapters with the specific matters on which we make recommendations. Thus in Chapter IV we deal with the question of the distribution and allocation of income-tax, and in the fifth chapter with the division of Union excises which we also recommend. Chapter VI treats of grants-in-aid in lieu of the jute-export duty which form a category of grants-in-aid by themselves. In Chapter VII we go on to formulate a few principles which should govern grants-in-aid of the revenues of States before setting out in Chapter VIII, our own proposals for grants-in-aid. Chapter IX gives a summary of our recommendations and in the final chapter we

make certain suggestions for the setting up of machinery for the collection and collation of material for the use of the Finance Commission in future. The appendices reproduce certain communications and give subsidiary information and statistical tables of interest, bearing on our work.

26. *Miscellaneous.*—Throughout this report references to Part A States are to the States including the “merged areas” and references to the Part B States should be read as excluding the State of Jammu and Kashmir.