meetings with the State Governments and the representatives of the Central Ministries are given in Appendix VIII.

11. We shall now give a brief account of the scheme of the report. It should be treated, generally, as a continuation of the report of the last Commission. In regard to the historical background and the statistical data, we have not considered it necessary to go over the ground already covered in the report of our predecessors. We have, however, tried to bring the material up-to-date. In Section II, we have briefly reviewed the constitutional and other developments since the report of the last Commission. In Section III, we have considered the functions of the Finance Commission *vis-a-vis* the Planning Commission, in the context of the impact of the first and second five year plans on the finances of the Union and the States. In Section IV, we have examined certain aspects of the constitutional provisions relating to the functions of the Commission. In Section V, we have attempted a brief survey of recent trends in federal finance in some other countries. In Section VI, we have dealt with the principles of grants-in-aid and in Section VII, we have reviewed the States' finances since the last Commission's report. In Section VIII, we have broadly explained the manner in which we have assessed the needs of the States. In the next eight Sections, we have dealt successively with the distribution of taxes on income, the division of Union duties of excise, the determination of grants-in-aid payable in lieu of jute export duty, the determination of grants-in-aid under the substantive portion of article 275 (1), the distribution of estate duty, modification of the terms of Union loans to States, the distribution of the additional duties of excise to be levied in lieu of sales taxes on mill-made textiles, sugar and tobacco and the distribution of the tax on railway fares. We have added a Section dealing with some miscellaneous points arising out of our work and have wound up the report with a resume of our recommendations, a concluding Section and acknowledgements.

II. First and Second Commissions

12. Under the provisions of the Constitution, a Finance Commission has to be appointed on the expiry of every five years or earlier if the President so desires. This ensures a measure of continuity in the work of these Commissions and each Commission gets the advantage of the work of its predecessors. Our task as the second Commission has, in many ways, been made easy by the work of the first Finance

Commission. Their report has clarified the main issues and has set the general pattern on which reports are likely to be made under the present provisions of the Constitution regulating the financial relations between the Union and the States. The rules of procedure, as laid down by them, have been the model on which we framed our own rules. We have made full use of the historical and statistical data contained in their report.

13. While our task has thus been made simpler in some ways, it has been somewhat complicated by the constitutional and other developments subsequent to the last Commission's report. Since 1952, far-reaching changes have been made in the structure and organisation of the component States of the Indian Union. With effect from 1st October 1953, the new State of Andhra was carved out of the former State of Madras. This was a prelude to the more extensive reorganisation of States. The States Reorganisation Commission was appointed in December 1953 and submitted their report to the Government of India on 30th September 1955. The decisions of the Government on the report were embodied in three Acts passed by Parliament in August and September 1956, namely, the States Reorganisation Act, the Bihar and West Bengal (Transfer of Territories) Act and the Constitution (Seventh Amendment) Act.

14. The reorganisation has affected all the States except Assam, Orissa, Uttar Pradesh and Jammu and Kashmir. All the Part B States and Part C States have disappeared. Punjab has been enlarged by the merger in it of the Patiala and East Punjab States Union and Rajasthan by the merger of the former Part C State of Ajmer. Saurashtra and Kutch along with the Marathi-speaking areas of the former States of Hyderabad and Madhya Pradesh have been merged in Bombay. Mysore has been enlarged by the inclusion of Coorg and the Kannada-speaking areas of Bombay, Hyderabad and Madras. Travancore-Cochin has been converted into the new State of Kerala by the transfer to it from Madras of the Malabar district and the Kasaragod taluk of the South Kanara district, while five Tamil-speaking taluks have been transferred from Travancore-Cochin to Madras. The Telugu-speaking districts of Hyderabad have been added to Andhra to form the new State of Andhra Pradesh. The Hindi-speaking districts of Madhya Pradesh have been added to Madhya Bharat along with Vindhya Pradesh and Bhopal to form the new State of Madhya Pradesh. An area of roughly 3,000 square miles has been transferred from Bihar to West Bengal. These changes came into effect on 1st November 1956.

15. There are now only fourteen States and six Union territories, the latter being directly administered by the Union Government, with their receipts and expenditure forming part of the Consolidated Fund of India. This radical reorganisation may simplify the task of future Finance Commissions. But our task was complicated by the break in the continuity of the majority of the States and the difficulty of arriving at estimates of their financial position, consequent upon the extensive territorial changes.

16. In April 1953, the Government of India appointed a Taxation Enquiry Commission to make a comprehensive enquiry into the tax system of the country. Their report was published early in 1955 and has been under consideration of the Union and State Governments. Of their recommendations, those relating to the sales taxes were particularly important and, so far as they concerned the Union Government, they have been implemented by the enactment of the Constitution (Sixth Amendment) Act and the Central Sales Tax Act. Many of the State Governments are still in the process of revising their sales tax laws in the light of the recommendations of the Commission.

17. Another development was the financial integration of Jammu and Kashmir with India. Under articles 278 and 295 of the Constitution, as applied to that State by the Constitution (Application to Jammu and Kashmir) Order 1954, the Government of India and the Government of Jammu and Kashmir entered into an agreement under which the State Government became entitled to receive its share of the divisible pool of taxes on income and of Union duties of excise as well as grants-in-aid on the pattern applicable to other Part B States. This agreement, which came into effect on 1st April 1954, was to continue in force until terminated or modified after consideration of the report of the Finance Commission constituted after the commencement of the order. Jammu and Kashmir thus came within our purview and we included it in the scope of the recommendations made in our *interim* report. After the receipt of that report the President terminated the agreement with effect from 1st April 1957, from which date Jammu and Kashmir stands in the same position as the other States for purposes of sharing taxes and receiving grants from the Union.

18. The scope of our work is also somewhat wider because of the additional references which have been made to us. We have been asked to advise on the principles to be embodied in the law of Parliament regarding the distribution of the net proceeds of the estate duty

on property other than agricultural land and the tax on railway fares. Similarly, we have been asked to make recommendations regarding the principles of distribution of the additional duties of excise proposed to be levied by the Union in replacement of the States' sales taxes on mill-made textiles, sugar and tobacco and the amounts to be guaranteed to the States as their present income from sales taxes on these commodities. We have further to advise the President on modifications which may be necessary or desirable in the rates of interest and the terms of repayment of the loans made to the State Governments by the Government of India between 15th August 1947 and 31st March 1956.

19. Our terms of reference enjoin that, in recommending the grants-in-aid of the revenues of the States, we should, among other matters, have regard to the requirements of the second five year plan. We have, therefore, sought to make provision in our scheme of devolution for its implementation. The first five year plan was in operation when the last Commission considered the problem of the States' finances. They made no specific recommendation regarding the implementation of the plan and left it to be financed partly by the additional revenue to be raised by the States, partly by the devolution proposed by them and partly by grants from the Union under article 282 of the Constitution. In the result, out of the estimated revenue expenditure of Rs. 333 crores in the last four years of the first plan, the States met Rs. 77 crores from the proceeds of additional taxation, Rs. 133 crores from grants under article 282 of the Constitution and Rs. 66 crores from the devolution made on the recommendations of the last Commission, and were left with an overall deficit of Rs. 57 crores. The five year plan has now become an integral part of the budgets of the Union and the States and the basic needs of the States cannot be considered in isolation from the needs for development as embodied in the plan. The sums involved in the second plan are much larger than in the first plan and we feel that it will be inappropriate to leave them outside our scheme of devolution. In our assessment of the needs of the States, we have, therefore, taken into account their basic as well as developmental needs.

20. This immediately posed the question of how the developmental needs, to the extent to which they have to be met from the revenue budgets of the States, should be determined. In the memoranda submitted to us by some of the State Governments and in our discussions with them, they made the point that in certain spheres the plan was insufficient and claimed assistance from us for enlarging it. The