XVII Miscellaneous

183. It now remains for us to deal with certain other matters of interest which arose in the course of our work.

184. In our study of the expenditure in recent years of State Governments, we were struck by the dislocation caused to the finances of many of them by unforeseen expenditure on natural calamities like famine, droughts and floods and we were impressed with the need for making some regular provision to meet this type of expenditure. In our estimate of the committed expenditure of the States, we have included a margin for enabling them to set apart annually from their revenue sizeable sums to be accumulated in a fund for meeting expenditure on natural calamities. The annual amounts, based roughly on the average annual expenditure over the last decade, which we have allowed for the individual States, are:

State	Amount (Rupees in lakhs)
Andhra Pradesh	75
Assam	25
Bihar	100
Bombay	40
Kerala	10
Madhya Pradesh	15
Madras	50
Mysore	30
Orissa	50
Punjab	40
Rajasthan	40
Uttar Pradesh	50
West Bengal	80
Jammu and Kashmir	10
Total	615

We suggest that the State Governments be invited to set up separate funds and transfer these amounts every year to such funds. If any State has an existing fund, its scope should, where necessary, be widened to cover all natural calamities. The balances of the funds should be invested in readily marketable Government securities so that they may be available when needed, without the States having, except in very abnormal circumstances, to curtail their other expenditure or approach the Union for assistance. We trust that the State Governments will welcome this suggestion and take appropriate action to implement it.

give, as nearly as possible, an allocation of passenger travel in terms of passenger earnings. The distribution of the tax in the ratio of the earnings thus allocated will give to each State a share that will approximate closely to the actual passenger travel in it.

180. We have next to decide whether the distribution each year should be made on the allocation of the earnings of that year. We feel that this will be a cumbrous and inconvenient arrangement. It is desirable that the States should know in advance the shares of revenue they are entitled to get. It is reasonable to work out the States' shares on the basis of the average of recent earnings and express these shares as fixed percentages applicable for five years from 1957-58. In order to even out fluctuations, we have taken the figures of passenger earnings (exclusive of earnings of suburban services) for the last three years (ending March 1956), for which actuals are available and have worked out the shares of the States on the basis explained above. These come to:

State	Percentage
Andhra Pradesh	8·86
Assam	2·71
Bihar	9·39
Bombay	16·28
Kerala	1·81
Madhya Pradesh . . .	8·31
Madras	6·46
Mysore	4·45
Orissa	1·78
Punjab	8·11
Rajasthan	6·77
Uttar Pradesh	18·76
West Bengal	6·31

181. We recommend that the net proceeds of the tax be distributed in accordance with these percentages after deducting one quarter per cent for proceeds attributable to Union territories.

182. While this recommendation may hold good for the period of five years ending 31st March 1962, we suggest that steps be taken to investigate if the railways could not, without undue labour or expense, maintain state-wise statistics of route mileage, traffic and earnings to facilitate the consideration of alternative methods of distribution.

185. In May 1957, the Government of India drew our attention to their scheme of assistance in connection with the revision of the salaries of the low-paid employees in State services, embodied in their communication to the State Governments dated the 20th February 1957, reproduced in Appendix XI. Under this scheme, the Centre offered to meet two-thirds of the extra expenditure necessary to bring the total emoluments to Rs. 60 per mensem and one-third of the extra expenditure on account of the increase in emoluments beyond Rs. 60 per mensem and upto Rs. 100 per mensem. The assistance was subject to the further conditions that in any individual case the amount of increase should not exceed Rs. 12 per mensem, and that the revision should not have the effect of increasing the State scales of pay beyond the corresponding Central scales in any case and should not apply to industrial or other establishments for which scales of pay are normally fixed at market rates. This offer was for a period of four years from 1st April 1957, but was subject to reconsideration in the light of our recommendations.

186. We considered whether we could make any provision in our scheme of devolution for the expenditure involved in this revision. The quantum of expenditure will depend both on the extent to which a State may take advantage of the scheme and on the time when the revision may be given effect to. There is no reason to assume that all the States will take full advantage of the scheme or enforce it from 1st April 1957. We are, therefore, unable to make any provision for this additional expenditure in our scheme of devolution except to the extent to which revisions of pay had already been sanctioned and brought into force in any State before 20th February 1957, the date of issue of the Central Government orders Since the cost of such revisions has been included in our estimates of expenditure, the Central Government need not render any assistance in respect of them for any period after 1st April 1957. Regarding revisions sanctioned or brought into effect after the issue of the Central Government orders in February 1957, the States will not be in a position to meet their share of expenditure. It will be for the Central Government to decide the extent to which they should assist the States to meet the cost of such revisions.

187. Our attention was frequently drawn [illegible] in the standards of maintenance of public [illegible] lack of funds. This was specially stressed in respect of roads. We realise that this is largely a matter for the State Governments who have to use their revenues to the best advantage. But we should

like to sound a note of warning. It is, in the long run, wasteful to allow public assets to deteriorate for want of proper maintenance. In the case of roads, this will be particularly unfortunate in the larger economic interest of the country. Proper communications are essential for economic development, of the country and roads, often built at considerable cost, should not be allowed to deteriorate by lowering the standards of maintenance. We earnestly hope that in utilising the additional funds that may now be made available, the State Governments will bear this in mind.

188. We noticed that in some States administrative reorganisation, such as reorganisation of the police, was being undertaken. While we do not wish to express any opinion on the necessity for such reorganisation, we should like to urge the need for caution. With practically all the available resources earmarked for the plan or for meeting committed expenditure, administrative reorganisation involving increase in non-development expenditure should not be undertaken unless it is inescapable. Even then, it should be phased over as long a period as possible.

189. In formulating the second five year plan and assessing the resources available for it, the existing revenues of the States and the proceeds of future taxation had been fully taken into account, leaving the States without any margin for further commitments. Many State Governments complained that in spite of this, additional burdens were frequently placed upon them by Central policies. They mentioned, in this connection, two matters to which we would like to draw the attention of the Central Government.

190. The first relates to the system of matching grants. During the first five year plan period a number of schemes involving such grants were sanctioned and subsequently incorporated in the plan. A large number of such schemes have also been included in the second five year plan. The State Governments were unable to meet their share of the expenditure on these schemes as all their resources had already been committed for their inescapable expenditure for the implementation of the plan. Their difficulty was greater in the case of schemes outside the plan. In either case, they found it impracticable to reject the schemes on the ground of want of resources because of the understandable public criticism that they were not taking advantage of these schemes, desirable in themselves and having the added attraction of a Central subsidy. In the result, most of them accepted the schemes and ran into revenue deficits.

191. There is considerable force in this complaint. So far as the second five year plan is concerned, we have sought to meet it by taking into account in our scheme the requirements of the States for the plan as a whole including schemes involving matching grants, so that the States will have resources to meet their share of the expenditure. But we suggest that, for the future, no scheme outside the plan should be formulated on a matching basis. Except to a small marginal extent or when the scheme itself is related to the raising of a specific additional item of fresh revenue such as by the levy of a special tax or cess, there is, in our opinion, no room in present circumstances for matching grants. We think it unwise to encourage States to run into revenue deficits by accepting such schemes as all their revenue resources have, as already explained, been fully committed. Matching grants may be useful in ordinary circumstances as providing a stimulus to State action in particular spheres of activity, usually in the field of social services, in which the Centre desires to secure country-wide development in the national interest. They have no place when the country has an integrated and comprehensive plan which lays down priorities for the development of all social services. The system of matching grants on any basis uniform for all the States is also not equitable: it operates in favour of the richer and against the poorer States, as the former are in a more favourable position to take advantage of such grants. In the present Union-State set-up, the States depend for a substantial portion of their revenue on shares of Central taxes and on grants-in-aid. When the States have taxed themselves to a reasonable extent, the balance of the revenue to enable the States to meet their expenditure has to come from Central devolution. There is no method by which the States' share of the expenditure on schemes based on matching grants could be set off against revenue derived from their own sources, as distinguished from the revenue they receive from the Union by way of shared taxes and grants-in-aid. When the revenue budget is balanced by Central devolution, the States' share may come out of such devolution. If this happens, the whole purpose of matching is lost. For these reasons, we feel that schemes involving matching grants are not suitable in present conditions

192. The second matter mentioned by [illegible] instructions issued from time to time by Central Ministries suggesting to State Governments the adoption of measures which resulted in the reduction of their revenues such as the reduction of sales taxes

on particular commodities or in their incurring additional expenditure such as on the consolidation of holdings. Except when the amounts involved were inconsiderable, these placed a further strain on the States' resources and often led to their running into deficits. There is force in this complaint also.

193. Some State Governments complained that plan schemes involving Central assistance and included after discussion between them and the Planning Commission were again subjected to detailed examination by the Planning Commission and Ministries of the Government of India after they had been elaborated and scrutinised at the State level and that this frequently resulted in delays in their execution. We suggest that this matter be looked into by the Union Government in consultation with the Planning Commission. It is worth considering whether once a scheme has been accepted in broad detail and provision made for it in the plan, further scrutiny and sanction should not be left to the State Governments, subject to a financial ceiling for each scheme.

194. We experienced some difficulty in our study of the revenue and expenditure of the State Governments arising out of the existing accounting arrangements. In certain matters, the accounting procedure in the States is not uniform. For example, the procedure for the accounting of payments of compensation to local bodies varies from State to State. Similarly, there is no uniformity in the exhibition of transactions relating to industries. In certain States, receipts are taken gross and in others net, *i.e.*, after deduction of working expenses and depreciation. In some States, transactions connected with the purchase and sale of fertilisers are shown under the head "Agriculture" and in others under the head "Co-operation". In many States, plan expenditure is inextricably inter-mixed with normal expenditure so that it is not easy to derive the latter from the accounts. It is desirable to have one uniform accounting procedure for all the States and to exhibit the plan expenditure separately. We suggest that this matter may be examined in consultation with the Comptroller and Auditor General.

195. We were greatly handicapped in our work by the absence of reliable statistics, particularly those relating to consumption. The last Finance Commission had recommended that steps should be taken to compile statistics of consumption of the more important commodities subject to Union excise but actually very little has been done in this direction. We understand that the Central Board of

Revenue, which is mainly concerned with the collection of revenue at the point of production, is not in a position to maintain statistics of consumption. If this is correct, we suggest that other arrangements be made through agencies like the National Sample Survey for the collection of these statistics. If the ordinary rounds of the National Sample Survey are not adequate, special enquiries may be instituted for this purpose, preferably with a sample design based on multiple stratification according to regional variations in consumption as well as variations between rural and urban areas. We also noticed that reliable figures of collection of sales taxes on individual commodities were not available in many States. We suggest that State Governments should be invited to take necessary steps to have this information collected in future. The importance of having reliable statistics of consumption and of collection of sales tax by commodities has now been underlined by the proposal to levy an additional excise duty on certain commodities in replacement of sales taxes on them. We trust that urgent attention will be paid to both these matters.

196. Our predecessors had recommended the establishment of a cell in the President's Secretariat to collect and maintain up to date data likely to be of use for future Commissions. We understand that this was tried and found unsuitable and that, following the recommendation of the Taxation Enquiry Commission, this cell has since been merged in the Finance Ministry. We, however, consider it essential that a nucleus staff with experience of the work of the Finance Commission should be retained within the Finance Ministry and made available to future Commissions. We also suggest that arrangements be made by the Finance Ministry for the necessary statistical and other research work likely to be of assistance to them.

197. Finally, we would like to draw attention to certain constitutional implications of the changing pattern of financial relations between the Union and the States. Among the shared taxes, income-tax is losing its dominant position. The amount of excise revenue given to the States by the first Finance Commission was about one-third of the amount devolved through share of income tax. According to our recommendations, the proportion will rise to nearly one-half and it seems inevitable that it will continue to rise still further. The change is even more striking in respect of grants. The grants given under article 282 are already greater than the grants-in-aid of revenues given under article 275 (1). According to our recommendations, the latter will amount to Rs. 190 crores as against Rs. 275

crores likely to be received by the States under article 282. With the levy of estate duty and tax on railway passenger fares, article 269 is emerging as an important source of revenue to the States. Earlier in Section III we have pointed out that the scope of the work of the Finance Commission in assessing the needs of the States has become restricted as a result of the setting up of the Planning Commission. For all these reasons, it is for consideration whether the time is not ripe for a review of the constitutional provisions dealing with the financial relations between the Union and the States.

XVIII. Recommendations

198. Our recommendations to the President are set out below:—

I. Under article 270 of the Constitution—

(a) the percentage of the net proceeds in any financial year of taxes on income other than agricultural income, except in so far as those proceeds represent proceeds attributable to Union territories or to taxes payable in respect of Union emoluments, to be assigned to the States be 60 (sixty);

(b) the percentage of the net proceeds of taxes on income which shall be deemed to represent proceeds attributable to Union territories be 1 (one); and

(c) the percentage of the net proceeds assigned to the States be distributed among those States as follows:—

State	Percentage
Andhra Pradesh	8·12
Assam	2·44
Bihar	9·94
Bombay	15·97
Kerala	3·64
Madhya Pradesh	6·72
Madras	8·40
Mysore	5·14
Orissa	3·73
Punjab	4·24
Rajasthan	4·09
Uttar Pradesh	16·36
West Bengal	10·08
Jammu and Kashmir	1·13