VII. Review of State Finances

67. We shall now review briefly the trends in the revenue and expenditure of the State Governments during the period following the report of the last Commission. We propose to confine this review to the four years ending 1955-56, although the recommendations of the last Commission covered the year 1956-57 as well. This is because the financial picture was altered in November 1956 by the reorganisation of States. The four-year period is also convenient as it covers the last four years of the first plan and the actuals of these years reflect the impact of the plan on the State revenues.

68. Before dealing with individual States it will be interesting to view the picture for all the States taken together. In the four years covered by our review, the States excluding Jammu and Kashmir, which was not included in the last Finance Commission's scheme, had a cumulative revenue deficit of Rs. 57 crores. In this period, the revenue expenditure on schemes included in the first five year plan amounted roughly to Rs. 333 crores. The States received from the Union, under article 282 of the Constitution, grants amounting to Rs. 133 crores while they raised additional revenue of Rs. 77 crores. For the remaining plan expenditure amounting to Rs. 123 crores, they were able to utilise Rs. 66 crores which they had as surplus from their ordinary revenues and devolution under the scheme of the first Finance Commission, leaving an uncovered deficit of Rs. 57 crores. The scheme of devolution recommended by the last Commission did not make any direct provision for implementation of the first five year plan; it, however, turned out to be quite liberal in relation to the normal expenditure of the States and for most of them left a substantial margin which helped them in implementing the plan. Because of this liberal devolution, the States did not find it necessary, during the period of the first five year plan, to hold up any scheme for lack of funds, although some of them ran into sizeable deficits. The States did not also find it necessary to draw to any substantial extent upon their accumulated reserves for augmenting their revenues. For all Part A and Part B States together, excluding Jammu and Kashmir, the total withdrawals from reserves during the last four years of the first five year plan amounted only to Rs. 22 crores. Bihar withdrew in this period Rs. 8·5 crores, Bombay Rs. 3·5 crores, Madhya Pradesh Rs. 7·02 crores and Uttar Pradesh Rs. 2·92 crores.

69. We may now turn to a consideration of the position of individual States. Bombay, Madhya Pradesh, Punjab, Rajasthan, Travancore-Cochin and Uttar Pradesh ended this four-year period with

assessment of tax effort we have assumed that if a State raised additional revenue which it has promised for the plan, it will have done its part.

65. Another consideration, which weighed with the previous Commission, is the function of grants-in-aid in reducing inequalities in the standards of basic social services in the States. We recognise that maintenance of certain important services at a minimum national level may justify giving special grants-in-aid. Since total resources are limited, this can be achieved only by stages. We have taken the view that it is the function of the Planning Commission and the National Development Council to ensure the equalisation, as far as practicable, of the standard of essential social services in the various States of the Union. To the extent that plan expenditure incurred on raising the level of social services has become committed expenditure, we have taken it into account. For our scheme of devolution, we have accepted the plan as ensuring an equitable development in the field of social services. There is, therefore, now no room for any grants in this field, such as the grant for expansion of primary education recommended by the last Commission.

66. The principles of grants-in-aid, which we recommend, are as follows:

(i) The eligibility of a State to grants-in-aid and the amount of such aid should depend upon its fiscal need in a comprehensive sense. In a Union, in which the Centre and the States co-operate for planned development, grants-in-aid should subserve this end. Priorities and provisions in the plan itself should determine the fiscal needs for development for the period of the plan.

(ii) The gap between the ordinary revenue of a State and its normal inescapable expenditure should, as far as possible, be met by sharing of taxes. Grants-in-aid should be largely a residuary form of assistance given in the form of general and unconditional grants.

(iii) Grants for broad purposes may also be given. While they last, they should be grants-in-aid of revenues, but the States would be under an obligation to spend the whole amount in furtherance of the broad purposes indicated. Where those purposes are provided for in a comprehensive plan, there will be no scope for such grants.

substantial revenue surpluses while Andhra, Assam, Bihar, Hyderabad, Madras, Orissa, Pepsu, Saurashtra and West Bengal had substantial deficits, Madhya Bharat and Mysore having a nominal surplus. The table below shows the cumulative surplus or deficit of each State for this period:

(Rupees in lakhs)

State	Surplus	Deficit
Andhra	..	1161
Assam	..	313
Bihar	.	948
Bombay	935	..
Hyderabad	..	295
Madhya Bharat	45	..
Madhya Pradesh	445	..
Madras	..	2521*
Mysore	21	..
Orissa	..	842
Pepsu	..	206
Punjab	248	
Rajasthan	552	
Saurashtra	..	
Travancore-Cochin	660	..
Uttar Pradesh	474	..
West Bengal	.	2555
Total	3380	9092
Net deficit . .		5712

*For composite Madras upto September 1953 and for residuary Madras thereafter.

If the transfers to revenue from reserves during the period are excluded, Bombay's surplus drops to Rs. 5·85 crores and that of Uttar Pradesh to a marginal Rs. 1·82 crores, while the surplus of Madhya Pradesh is converted into a deficit of Rs. 2·57 crores and the deficit of Bihar raised from Rs. 9·48 crores to Rs. 17·98 crores.

70. The relatively comfortable position of Bombay, Punjab and Uttar Pradesh was due to their tax effort; these three States raised Rs. 24 crores, Rs. 4.5 crores and Rs. 11 crores respectively during the period. The deficits of the remaining States reflect the impact of the plan on their revenues and, except in the case of Assam, also their failure to raise the additional revenue expected of them. In the case of Andhra the position appears to have been aggravated by an imbalance in its ordinary revenue position.

71. The total revenue of the States, excluding Union grants and shares of divisible Union taxes and transfers from revenue reserve

funds, showed a significant increase from Rs. 332 crores in 1951-52 to Rs. 415 crores in 1955-56. Of this increase, Rs. 55 crores occurred under the principal revenue heads. Land revenue, which accounted for a little less than 20 per cent of the revenue from principal heads in 1951-52, accounted for a little over 25 per cent in 1955-56, the yield rising from Rs. 48 crores to Rs. 78 crores, largely the result of the abolition of zamindari. The revenue from State excise duties declined from a little over Rs. 49 crores in 1951-52 to Rs. 42 crores in 1955-56, its share in the total revenue declining from 20 per cent to 14 per cent. Stamps and Forests showed a slight increase but there was no significant change in their position as components of the revenue. Receipts from motor vehicles rose from Rs. 9·79 crores in 1951-52 to Rs. 15.67 crores in 1955-56, while 'Other Taxes and Duties' expanded from Rs. 87·95 crores to Rs. 104·27 crores.

72. Part of the increase in the revenue of the States was due to the additional taxation imposed during the period. The first five year plan assumed that, in the period covered by it, the States taken together would raise a sum of Rs. 230 crores for financing the plan. In most States, the additional taxation fell far short of the target, only Assam, Bombay, Punjab and, to a certain extent, Rajasthan being exceptions. The statement below shows the target fixed for the individual States and the amounts actually raised by them, according to the estimates of the Planning Commission:

(Rs. in crores)

State	Five year target	Achievement (1951-56)	Achievement expressed as a percentage of target
Assam	3·5	3·3	94·29
Bihar	7·3	3·0	41·10
Bombay	23·5	24·0	102·13
Madhya Pradesh	10·6	2·3	21·70
Madras (including Andhra)	39·3	8·0	20·36
Orissa	9·4	2·0	21·28
Punjab	5·0	4·5	90·00
Uttar Pradesh	50·2	11·0	21·91
West Bengal	36·9	4·5	12·20
Hyderabad	7·4	1·0	13·51
Madhya Bharat	4·9	2·7	55·10
Mysore	9·2	3·0	32·61
Pepsu	4·1	0·4	9·76
Rajasthan	3·3	2·6	78·79
Saurashtra	4·7	2·1	44·68
Travancore-Cochin	11·0	6·0	54·55
Total	230·3	80·4	34·91

73. Out of the additional revenue raised during the period of the first five year plan, about 50 per cent was accounted for by sales taxes and taxation of motor spirit and tobacco and 20 per cent by motor vehicles, passenger and carriage taxes. The balance was raised by a number of minor taxation measures. Taxation of land contributed very little and, except in Uttar Pradesh, irrigation rates also did not contribute any sizeable amount.

74. The increase in the yield of the principal heads of revenue in 1955-56 as compared to that in 1951-52 was Rs. 55 crores. A state-wise analysis of the yield from the principal heads of revenue is given below:

(Rupees in crores)

State	Yield from principal heads of revenue in 1951-52	Yield from principal heads of revenue in 1955-56
Andhra	*	14·17
Assam	6·41	10·63
Bihar	15·56	18·43
Bombay	36·95	52·07
Hyderabad	21·89	18·12
Madhya Bharat	7·81	9·00
Madhya Pradesh	16·18	17·03
Madras	37·83**	30·42
Mysore	6·88	9·33
Orissa	6·38	6·86
Pepsu	4·35	4·79
Punjab	8·67	10·76
Rajasthan	11·49	10·96
Saurashtra	2·96	5·01
Travancore-Cochin	10·54	11·00
Uttar Pradesh	30·79	45·72
West Bengal	23·86	29·13
TOTAL	248·55	303·43

*Included in Madras.

**Includes Andhra.

The improvement was of the order of 5 per cent per annum, it was due partly to the normal expansion of revenue, partly to increased receipts of land revenue in certain States owing to the abolition of zamindari and partly to the additional taxation, mentioned earlier, imposed for financing the plan.

75. A disturbing feature in the revenue position of most States was the deterioration in the net receipts from irrigation and electricity undertakings. An analysis of the net return in respect of irrigation works other than multi-purpose projects is given below:—

Net receipts from irrigation works (commercial) after deduction of interest charges

(Rupees in lakhs)

State	1951-52	1952-53	1953-54	1954-55	1955-56
Andhra	..	..	(+)40·60	(—)221·74	(—)230·00
Assam	..	..	..	..	..
Bihar	(—)28·32	(—)3·04	(—)29·84	(—)46·67	(—)47·00
Bombay	(—)28·03	(—)17·62	(—)28·78	(—)48·05	(—)64·00
Madhya Pradesh	..	..	..	..	..
Madras	(—)97·90	(—)180·31	(—)251·96	(—)106·68	(—)201·00
Orissa	(—)10·67	(—)12·32	(—)19·39	(—)23·69	(—)40·00
Punjab	(+)57·89	(+)131·19	(+)185·85	(+)138·97	(+)63·00
Uttar Pradesh	(+)136·31	(+)96·21	(+)192·87	(+)208·41	(+)47·00
West Bengal	(—)21·13	(—)22·69	(—)11·75	(—)29·17	(—)19·00
Hyderabad	(—)8·04	(—)11·00	(—)9·25	(—)9·25	(—)11·00
Madhya Bharat	..	..	..	..	(+)12·00
Mysore	(+)3·14	(+)9·30	(+)2·43	(+)4·38	(+)7·00
Pepsu	(+)36·97	(+)35·03	(+)40·28	(+)34·47	(+)1·00
Rajasthan	(+)9·24	(—)5·77	(—)16·95	(+)4·41	..
Saurashtra	(—)5·09	(—)8·86	(—)13·41	(—)18·39	(—)25·00
Travancore-Cochin	(—)0·47	(—)1·07	(—)0·96	(—)3·84	(—)7·00
TOTAL	(+)43·90	(+)9·05	(+)79·74	(—)116·84	(—)514·00

Note :—Interest not debited to the major head "17—Irrigation, Navigation, Embankment and Drainage Works (Commercial)" in Hyderabad, Madhya Bharat, Mysore and Pepsu.

It will be seen that at the end of the first five year plan only two States, namely, Punjab and Uttar Pradesh, were able to obtain a net return from productive irrigation works after meeting interest and other charges.

76. There has been noticeable delay in the utilization of major irrigation works and tubewells. For all Part A and Part B States, excluding Jammu and Kashmir, it was anticipated in the first five year plan that an additional 8.3 million acres or so would be brought under irrigation in the area commanded by major projects. Recent estimates put this figure at less than 4 million acres.

77. The delay in the utilisation of costly works naturally imposes a heavy financial burden. The full extent of this burden on the revenue budgets is not yet apparent, because in respect of a number

of major works, like Bhakra Nangal, Hirakud and Chambal, which are in the process of construction, the interest on outlay is still being added to capital. We apprehend that some time towards the end of the second five year plan period, when some of these projects will be completed, the impact on the revenue budgets of the results of their working will cause anxiety.

78. In respect of electricity undertakings only four States, namely, Madras, Mysore, Punjab and Uttar Pradesh, derived, according to the information supplied to us by the State Governments, an appreciable net return after providing for interest and other charges. The financial results in other States were far from satisfactory. The broad position is indicated by the table below:—

Total net receipts from electricity schemes in the four years ending March, 1956

	(Rupees in lakhs)
Andhra	—283*
Bihar	—52
Hyderabad	—11
Madhya Bharat	+28
Madras	+180*
Mysore	+149
Orissa	—59
Pespu	+34
Punjab	+197**
Rajasthan	—74†
Saurashtra	—8
Travancore-Cochin	—54**
Uttar Pradesh	+87†
West Bengal	—8†

*Includes for the year 1953-54 actual results of undertakings located in the Andhra and Madras areas respectively.

**Taken from budgets; in all other cases, based on actual results of the major undertakings as furnished by the State Governments.

†For three years ending March 1955.

79. In a formal sense, this problem, perhaps, is no longer the direct concern of the State Governments, since Electricity Boards have been established in some States and will soon be established in others. The mere transfer of the undertakings to autonomous statutory boards will not, however, solve the problem. The State Governments should take adequate steps to ensure that these boards are run in such manner that they are able to meet the interest burden on the outstanding loans due to the States. States, which are not now levying an electricity duty because the electrical undertakings are state-owned, may strengthen their revenue position by levying it.

80. Concern was expressed by the States deriving appreciable net revenue from electrical undertakings about the adverse effect on their revenues of the transfer of the State undertakings to the Electricity Boards. The payments by these Boards of interest on account of the capital loaned to them by the States has not been accorded sufficient priority in the Electricity (Supply) Act, 1948 and there is reasonbale ground for apprehension that the States may not be able to collect regularly even the interest from the Boards. Further, the Boards being subject to income tax, the States, which have been getting a net revenue from electricity undertakings, are now likely to lose part of it.

81. In more than one State, there has been accumulation of losses in the working of transport, industrial and commercial undertakings. There seems to be inadequate appreciation of the need to run such undertakings on a commercial basis and with a view to bringing a net return to the State exchequer.

82. In a number of States, there has been a steady increase in recent years in the accumulated arrears of revenue. To some extent, particularly in the case of arrears of land revenue and irrigation rates, this might have been due to failure of crops. We were, nevertheless, left with the impression that sufficient attention was not always paid to the recovery of these arrears. The position appears to be the same in the case of loans also. It is hardly necessary to emphasise the need for reducing the overdue arrears, as this will materially assist the States in implementing their development plans.

83. The total expenditure met from revenue, excluding transfers to revenue reserve funds, rose from Rs. 409·57 crores in 1951-52 to Rs. 609·08 crores in 1955-56. Expenditure on tax collection showed a significant increase of 57 per cent, rising from Rs. 35·59 crores in 1951-52 to Rs. 55·94 crores in 1955-56. Land revenue accounted for nearly 60 per cent of the increase; in certain States large sums were set apart for payment of compensation on the abolition of zamindari, while in many others increased expenditure was incurred on survey and settlement. Interest charges rose by nearly 200 per cent, reflecting a steady increase in the States' debt, mostly for financing the execution of capital schemes in the plan. During this period the public debt of the States rose from Rs. 390 crores at the end of 1951-52 to Rs. 1163 crores at the end of 1955-56. Expenditure

on Administrative Services increased by about 12 per cent, the bulk of it occurring under General Administration and Police, the expenditure on the former rising from Rs. 33·7 crores to Rs. 42·41 crores and that on the latter from Rs. 54·9 crores to Rs. 58·24 crores. Expenditure on social services increased by 55·7 per cent, mostly on account of development. Expenditure on Education increased from Rs. 60·30 crores to Rs. 98·89 crores, on Medical and Public Health from Rs. 29·21 crores to Rs. 44·56 crores, on Agriculture from Rs. 18·87 crores to Rs. 25·78 crores, on Veterinary Services from Rs. 4·07 crores to Rs. 5·62 crores and on Co-operation from Rs. 3·75 crores to Rs. 6·32 crores. Miscellaneous and other expenditure rose by 60 per cent, mainly under Civil Works. In many States, larger sums were spent on maintenance and minor works while in some others there was also considerable expenditure on flood and famine relief. On the whole, non-developmental expenditure appears to have risen at a pace somewhat more rapid than was envisaged in the plan, but part of the increase was perhaps unavoidable.

84. The main points brought out by the review of the States' revenue and expenditure may now be summarised:

(a) The scale of devolution recommended by the last Finance Commission was generally adequate for the normal expenditure of most States and left for many of them a sizeable surplus for meeting their plan expenditure.

(b) The tax effort of many States during this period fell far short of the expectations of the Planning Commission. If they had raised the resources expected of them, some of the States, which ran into deficits, might not have done so.

(c) The level of arrears of revenue and overdue loans in some States is a matter of concern and special efforts would seem to be necessary to reduce these arrears.

(d) The public debt of the States is increasing rapidly on account of the implementation of the plan. A considerable part of it may turn out to be deadweight debt and the cost of its servicing will fall on general revenues. Efforts should be made to ensure that irrigation, electricity, transport, commercial and industrial schemes yield the maximum revenue so as to keep down the net burden of interest charges.

(e) Expenditure has been steadily rising as a result of development; non-developmental expenditure has risen at a pace somewhat in excess of that envisaged by the plan.

VIII. Assessment of Needs of States

85. In examining the claims put forward by the States, our main objective has been to ensure that the States should have sufficient revenues to meet normal expenditure and their commitments in respect of the plan expenditure on revenue account.

86. For arriving at what may be regarded as a reasonable level of normal or committed expenditure, certain adjustments have been made by us to secure uniformity in classification.

87. We have omitted from our estimates all items of a capital nature. Most of the States had already removed from the revenue budgets many such items as a result of the suggestions made to the State Governments by the Government of India in October 1955. The object was to transfer from the revenue budget to the capital budget all items of expenditure which created tangible assets. This change is not unreasonable in a period of expansion though, under ordinarily circumstances, there may be justification for meeting unproductive capital expenditure from revenue. It may also be supported by the argument that the State Governments, which now derive about 30 per cent of their budgeted revenues from payments made in some form or other by the Union, are not justified in presenting to the Union Government an exaggerated picture of their needs on revenue account, by including within that account expenditure which can be reasonably treated as of a capital nature.

88. No provision has been made by us for payments from revenue towards the capital cost of the abolition of zamindari. The total amount of compensation cannot yet be closely estimated, as in some States like Bihar the detailed information, which is necessary for this purpose, is still being collected. On a rough estimate, however, the capital payments for the extinction of all proprietary and intermediary rights in land (excluding rehabilitation grants) has been estimated at Rs. 380 crores. The bulk of this liability has accrued in two States, namely, Bihar and Uttar Pradesh. The sums involved in the case of some other States, namely, Rajasthan, West Bengal, Madhya Pradesh and Andhra Pradesh, are appreciable though not