

(4) the sum apportioned to property other than immovable property be distributed among the States in proportion to their population. The percentage share of each State will be as follows:—

State	Percentage
Andhra Pradesh	8.76
Assam	2.53
Bihar	10.86
Bombay	13.52
Kerala	3.79
Madhya Pradesh	7.30
Madras	8.40
Mysore	5.43
Orissa	4.10
Punjab	4.52
Rajasthan	4.47
Uttar Pradesh	17.71
West Bengal	7.37
Jammu & Kashmir	1.24

138. We also recommend that the principles of distribution suggested above take effect from the financial year 1957-58. In respect of the preceding period, their application will be difficult owing to reorganisation of the States and will require laborious calculations. As the total amount involved is not considerable, we recommend that the distribution already made be legally ratified.

XIV. Union Loans to States

139. The next question to be considered is the modification, if any, in the rates of interest and the terms of repayment of the loans made to the various States by the Government of India between 15th August 1947 and 31st March 1956.

140. In recent years there has been a phenomenal growth in the number and amount of the loans given by the Government of India to the States. On 15th August 1947, the total debt of the Provincial Governments to the Centre was only Rs. 43.97 crores. Between that date and 31st March 1951, the number of loans had risen by about 220 and the outstanding amount had gone up to Rs. 195.41 crores. During the period of the first five year plan, namely, from 1st April 1951 to 31st March 1956, the number of outstanding loans rose by about 2570, the total outstanding debt on the latter date being

have been provisionally distributed among the States in the same ratio as the States' share of the divisible pool of income tax.

135. A variety of suggestions were made by the States in regard to the principles of distribution. Andhra Pradesh, Bihar, Kerala, Punjab and Uttar Pradesh proposed population as a suitable basis. Mysore suggested that 90 per cent should be allocated on the basis of population and 10 per cent on the basis of collection; Madhya Pradesh, half by population and half in proportion to the population of scheduled castes and scheduled tribes; and Orissa, 20 per cent on the basis of area and the balance on the basis of population with a weightage for scheduled castes, scheduled tribes and backward classes. Assam wanted the portion attributable to immovable property to be distributed by location and the balance on the principles adopted for the distribution of income tax, while Madras favoured distribution in the same proportion as income tax. West Bengal was for distribution on the basis of attributability and Bombay, on the basis of collection. Rajasthan proposed that 80 per cent should be distributed on the basis of population and 10 per cent on the basis of backwardness and revenue needs, the balance of 10 per cent being reserved for border States. Jammu and Kashmir wanted the distribution to be half on the basis of population and half on the basis of area.

136. Estate duty being a tax on property, the basis of location would be the most appropriate principle of distribution. It is, however, not possible to apply this principle in the case of the part relating to movable property, which may be included in an estate, and in respect of it some general principle of distribution such as population is inescapable.

137. We, therefore, recommend:—

- (1) that out of the net proceeds of the duty in any financial year, a sum equal to one per cent be retained by the Union as proceeds attributable to Union territories;
- (2) the balance be apportioned between immovable property and other property in the ratio of the gross value of all such properties brought into assessment in that year;
- (3) the sum thus apportioned to immovable property be distributed among the States in proportion to the gross value of the immovable property located in each State;

approximately Rs. 900 crores. These loans have been made for a variety of purposes, but largely to implement the plan. The amounts of individual loans have ranged from small sums to crores of rupees. The rates of interest have varied from 1 to 5 per cent, some of the loans being free of interest. Except where a concessional rate has been given, the rates have generally been determined with reference to the redemption yield of Central loans with a remaining maturity approximating to the period for which the loans are given. A number of loans are due to be repaid in equated annual instalments, including both principal and interest. Others are repayable in periods ranging from 1 to 40 years.

141. Though the majority of the loans have been sanctioned from the Consolidated Fund of India, some have been given from the Special Development Fund built out of moneys made available through foreign assistance, such as the counterpart funds from the wheat loan provided by the United States of America and the resources received under the Colombo Plan and from the United States International Co-operation Administration.

142. The large number of loans given and the wide variations in the rates of interest and the terms of repayment have introduced an avoidable complication in the financial relations between the Union and the States. It will simplify matters and save a great deal of labour and accounting, if these loans are consolidated and the rates of interest and the terms of repayment rationalised.

143. We should like to deal first with two types of loans, which we do not propose to include in our scheme of consolidation and to which certain special considerations apply, namely, loans given for the rehabilitation of displaced persons and interest-free loans.

144. The terms on which loans have been given to the States for the rehabilitation of displaced persons have caused a great deal of discontent. These loans fall into two categories, namely, those sanctioned before 1st January 1950 and those sanctioned subsequently. In regard to the former category, the States have to bear initially and on a provisional basis fifty per cent of the shortfall in the actual collections of principal and interest in any year as compared with the amounts which are due to be recovered, the States are entitled in return on the same provisional basis fifty per cent of the excess collections over and above the amounts due. These losses and gains are intended to be set off against the disbursements, which may be due from the State

governments, when the final settlement takes place. In respect of loans granted after 1st January 1950, the Government of India has agreed to bear in full such losses on account of principal or accrued interest as may arise on account of default by the parties or individuals from whom they are due; but the State Governments have been asked, for the time being, to pay to the Union, in addition to the amounts collected from the displaced persons, ten per cent of the deficiency in collection, and have been allowed to retain ten per cent of the excess collection, if any.

145. All the States, to which these rehabilitation loans have been given, contended that the distinction between these two categories was unfair and untenable. They argued that these loans were, in a real sense, for State purposes, that the policy in respect of these loans was laid down by the Union and that the State Governments administered them merely as agents of the Union. They, therefore, urged that they should not be put to any loss on this account and that their sole obligation with respect to these loans should be to the Union whatever they were able to collect by way of interest and principal.

146. This request of the States is reasonable and we recommend that, with effect from 1st April 1957, the States should pay to the Union only the amounts of principal and interest they collect on account of these loans, including the arrears outstanding on that date. We do not apprehend that this will lead to any relaxation in the efforts of the State Governments to recover these loans; we are confident that they realise their responsibilities in this matter.

147. About 335 loans of the total value of approximately Rs. 100 crores have been given free of interest. They were mostly for the construction of educational buildings, assistance to handloom and cottage industries, industrial and other housing, etc. In many cases these loans have been passed on by the State Governments to local bodies, universities or other agencies on the same terms and conditions. Connected transactions cannot now be re-opened. We do not, therefore, recommend any modifications in the terms of repayment of these loans.

148. We should in this connection like to place on record our view that the policy of giving loans interest-free or at concessional rates of interest is open to objection. First, such a concession conveys a wrong impression regarding the interest burden which has to

met. Secondly, concessions of this kind are not subject to Parliamentary control as no funds are voted to cover them. We think that if a scheme has to be subsidised, the subsidy should be given directly and not through reduction in the interest charged. The revenue budgets should show the actual interest burden and any assistance sought to be given through concessional rates of interest should take the form of a direct subsidy.

149. We shall now deal with certain general issues raised by the State Governments. The Bombay Government contended that the average rates of interest charged on the loans had been appreciably in excess of the average cost of the Centre's own borrowings. This view was also advanced by West Bengal, Madras, Uttar Pradesh and Assam. These States argued that, in fixing the rates of interest, the Union Government should take into account foreign assistance received as grants or as loans at concessional rates of interest and the resources raised by deficit financing. Some State governments complained that even though particular development projects in their States were being financed by grants from foreign governments, the capital sums advanced were treated as normal interest-bearing loans. Many of them suggested that the loans they had taken for unproductive or semi-productive purposes should be written off or should bear nominal or reduced rates of interest.

150. Certain specific matters were raised by some States. Madras requested that the ways and means advance outstanding against it should be converted into an interest-free loan till 1958 and should bear a concessional rate thereafter. Punjab asked for conversion into grants of grow more food loans and also part of the loan taken for the construction of the capital at Chandigarh. Rajasthan asked for the conversion into a grant of the loan sanctioned to assist its ways and means position on the abolition of internal customs duties with effect from 1st April 1955. West Bengal renewed its request that the loan which was granted to wipe out the ways and means advance, with which it had started after partition, might be written off. Jammu and Kashmir wanted that the loans sanctioned to the State pending the finalisation of food subsidy payments should be made interest-free.

151. We have already indicated our objection to the grant of an indirect subsidy by way of concessional interest. At the same time, we think that the Union should not deal with the States as if it were a commercial banker. The Union and the States are partners in the

enterprise and national development, while there is no reason why the Union should lend to the States at less than the true cost of borrowing. If borrowing, there is no justification either for charging more than the true cost. In calculating such cost, all factors which affect the cost of borrowing should be taken into consideration.

152. We are not making any recommendations regarding the requests made to us for the setting up of certain banks as they are outside our terms of reference. Moreover, it would be inequitable to consider such claims on behalf of individual States except as part of a general plan of debt readjustment for which the time is perhaps not yet ripe.

153. In our view, there is no justification for the claim that the amount of foreign assistance for any schemes should be passed on wholly to the States in which the scheme financed by such assistance are located. Foreign assistance accrues to the country as a whole and it will not be fair to pass on the benefits to particular States just because the schemes financed by such assistance happen to be located therein. There is a case, however, for taking such foreign assistance into account in determining the overall rate of interest to be charged from the States and we have done so.

154. Similarly, we do not admit the claim that resources provided by deficit financing should be made available free to interest to the States. Deficit financing goes to increase the resources of the Union as a whole and is not earmarked for specific purposes. It is reflected in the issue of treasury bills on which interest has to be paid to the Reserve Bank. It is true that the bulk of this interest returns to the Union as part of the surplus profits of the Bank. In making our estimates of the resources available from the Union for devolution to the States, we have taken this factor into account. Moreover, we are concerned only with loans given between 15th August 1947 and 31st March 1956 and during this period the amount of deficit financing was not significant.

155. Some States pointed out the difficulties caused by the system of equated payments of principal and interest. Though this system may be suitable when there is scope for the repayment of the principal from revenue, it seems to us meaningless now in the context of the maximum utilisation of revenue for current development expenditure and the steady increase in the outstanding debt of the States to the Union.

... to the ... and rationalis-
... of the loans other than interest-free loans and the
loans for rehabilitation of displaced persons.

157. We have estimated the average cost to the Government of India of all its borrowings, including treasury bills and small savings, during the period from 15th August 1947 to 31st March 1956. In the light of this estimate and taking all relevant factors into account, we have come to the conclusion that the reasonable rate to be charged to the States by the Union should be 3 per cent and this rate should apply to all loans, irrespective of the period of maturity.

158. We consider that all loans, which bear a rate of interest of 3 per cent or more, should be consolidated for each State at 3 per cent. For purposes of repayment they should be split up into two categories. The loans due to be repaid within a period of twenty years from 1st April 1957 should be consolidated into one single loan repayable at the end of fifteen years; the rest, i.e., those repayable after twenty years from that date should be consolidated into another single loan repayable at the end of thirty years.

159. We wish, however, to make an exception regarding loans carrying rates of interest below 3 per cent. They have been made generally for unproductive or semi-productive purposes such as the development of cottage industries and minor irrigation. In our opinion, these loans should be consolidated at an average rate of $2\frac{1}{2}$ per cent, which we expect will enable the Government of India to recover from the States the same amount as at present on account of these loans. For the purpose of repayment, these loans should be split up into two categories in the same manner as the loans referred to in the previous paragraph.

160. To sum up, we recommend that the outstanding balances on 31st March 1957 of all loans by the Government of India to State Governments made between 15th August 1947 and 31st March 1956, excluding the loans given for rehabilitation of displaced persons and interest-free loans, be consolidated, for each State, as follows:—

- (i) the balances of all loans carrying interest at 3 per cent or more per annum and repayable on or after 1st April 1977, be consolidated into one single loan at 3 per cent per annum repayable on 31st March 1997;
- (ii) the balances of all loans carrying interest at 3 per cent or more per annum and repayable on or before 31st March

1977, be consolidated into one single loan at 3 per cent per annum repayable on 31st March 1972;

- (iii) the balances of all loans carrying interest at less than 3 per cent per annum and repayable on or after 1st April 1977, be consolidated into one single loan at 2½ per cent per annum repayable on 31st March 1987; and
- (iv) the balances of all loans carrying interest at less than 3 per cent per annum and repayable on or before 31st March 1977, be consolidated into one single loan at 2½ per cent per annum repayable on 31st March 1972.

161. We expect that the scheme of consolidation recommended above will result in a reduction in interest charges of about Rs. 5 crores per annum for all the States together.

162. As a result of this consolidation, besides the rehabilitation and interest-free loans, there will be only four loans due from each State to the Union in respect of the loans taken during the period 15th August 1947 to 31st March 1956. We feel that the implementation of this scheme will bring about a great deal of order and simplicity in this field.

163. In our plan of consolidation, we have included the loans given to the States from the Special Development Fund. We understand that, in respect of some of these loans, there is an obligation to make the amounts repaid available as a revolving fund for further lending. We do not think that this would justify the exclusion of these loans from our scheme. The Government of India will, no doubt, consider whether the amounts which are now creditable to this fund on repayment of the loans should be provided from their own resources.

164. Our recommendations apply only to the loans given between 15th August 1947 and 31st March 1956. We suggest, however, that the basic feature of our scheme may be considered for adoption for future years also. This will mean that each State will get only two loans a year, i.e., one medium-term and one long-term, at a rate of interest approximating to the net cost of all Union borrowings in that year. In that case, we would suggest that no regular loans, but only ways and means advances, be sanctioned in the course of a financial year, the amount being regulated with reference to the purpose for which the loans are to be given. After the close of the year, the total of such advances may be converted into two loans, a medium-term loan and a long-term loan, carrying interest at the rate calculated as suggested earlier in this Section.