

### MINUTE BY DR. P. V. RAJAMANNAR

[This Supplemental Note which I have decided to add to the main Report separately does not strictly relate to the terms of reference contained in the President's Order appointing the Commission. It follows that whatever is found in this Note does not in any manner affect the recommendations made by the Commission as a whole. It contains my own thoughts on certain topics which are intimately connected with the Union-State financial relations. The views expressed and suggestions made in this Note are entirely mine.]

The Federal principle requires that the general and regional governments of a country shall be independent each of the other within their respective spheres and shall be not subordinate one to the other, but co-ordinate with each other. Now, if this principle is to operate in practice, both the general and regional governments must each have independent control of financial resources sufficient to perform their respective functions. 'It is, therefore, as necessary that the State Governments should be able to command the means of supplying their wants, as that the national government should possess the like faculty in respect to the wants of the Union' (Federalist).

2. The problem is a difficult one, for it is a hard task to allot resources in such a way that resources and functions are harmoniously adjusted.

3. In practice, ideal distribution has not been possible under any Federal Constitution. In almost every one of the Federations, inadequacy of provincial finances is being met by discretionary grants made by the Federal Government to the Provinces. In every Federation there are regions or States which have not been able to afford to provide for the social services which pertain to their functions. Such regions and States are compelled to ask for assistance from the Federal or the Central Government.

4. Under the Indian Constitution, there has been a distribution of functions and allocation of tax-raising powers embodied in the lists in the Seventh Schedule. But it is clear that the allocation of the financial resources consequent on the powers conferred by the lists has not corresponded with the allocation of functions. In

India, the problem is met in a two-fold way. Firstly, by the provision for a distribution of certain revenues between the Union and the States. This distribution is quite distinct from the distribution of the subjects contained in the Lists. The distribution from article 268 onwards relates to taxes and duties levied by the Union in exercise of the powers conferred on it by the subject matter of such duties and taxes being included in the Union List. Articles 268, 269, 270 and 272, all relate to such duties and taxes which only the Union has the power to levy. Whether or not in respect of some of these duties and taxes, their inclusion in the Union List was on ground of convenience and the need for uniformity it does not matter. As the lists stand, these several taxes and duties mentioned in the section are Union levies. Some of these are only levied by the Government of India but are collected by the States and the proceeds are assigned to the States. Others are both levied and collected by the Government of India but are assigned to the States. Yet others are levied and collected by the Government of India but compulsorily distributed between the Union and the States. There are yet others which are levied and collected by the Government of India, in respect of which there is no obligation for distribution between the Union and the States; but Parliament may direct payment to the States of any part of the net proceeds of such duties.

5. Article 275 provides for money grants by the Centre which are not referable to any particular taxes or duties, but which are directed to be made over to such States as Parliament may determine to be in need of assistances. *Ex facie*, there is nothing in this article which confines its operation to filling up of any gap. Actually, this article has been construed as a residuary provision for grants to help the revenue gap of particular States to be covered if the amounts payable to such States in accordance with the scheme of distribution of taxes and duties were not adequate.

6. On a plain reading of the relevant articles of the Constitution, dealing with the distribution of revenues, and the functions of the Finance Commission, without being influenced by the events which have happened and circumstances which have prevailed subsequent to the Constitution, two things appear to me to be clear; namely (i) The assignment of certain taxes and duties in their entirety, and the obligatory and permissive division regarding other taxes and duties, were intended to augment the resources of the States. The amounts allotted to each State in accordance with this scheme of devolution would form part of the revenues of that State. They would be included in the Consolidated Fund of the State along with its

## OBSERVATIONS ON THE MINUTE OF DISSENT

The Minute of dissent by Shri Mohan Lal Gautam relates to the following points:—

- (i) Omission to include in the expenditure estimates, liability consequent on revision of dearness allowance and pay scales effected by the State Governments of Andhra Pradesh (on 1st July 1965), Mysore (on 22nd July 1965) and Uttar Pradesh (on 27th and 29th July 1965).
- (ii) Omission to include in the expenditure estimates of the States, liabilities which may accrue during the course of the next five years, though no decisions have been taken by the States. For example (1) Sinking fund for market loans (2) Provision for revision of dearness allowance and pay scales (3) Police re-organisation (4) Panchayat Raj Administration and (5) Administrative re-organisation.
- (iii) Distribution of the balance of the proceeds of additional excise duties in excess of the guaranteed amounts.

2. These points have been dealt with by us in appropriate paragraphs in the report, namely, para 129 for (i), paras 114, 128, 130 and 142 for (ii) and para 71 for (iii).

3. As has been explained in the relevant paragraphs, we have taken the view that each major item of contingent expenditure should be taken up with the Government of India as it arises and the Government of India should deal with it along lines of similar items specifically included in the Commission's award. We refused to act in a hurry over accepting financial implications of large policy measures arrived at by States themselves in a hurry and we contented ourselves with recommending that while a particular item of expenditure is in our opinion eligible for inclusion in the estimates of State expenditure, the accuracy of the financial provision asked for must be tested by more careful scrutiny than the Commission could give it. The number of States coming forward with fresh schemes appeared to be almost unending. We felt that it would be difficult to make a fair and reasonable assessment taking all the relevant factors into account within the few days available to us after the receipt of these additional claims. Indeed even if our tenure had been extended and we had decided these particular

cases after such further discussions with the State Governments as were necessary, that would merely have resulted in some other States being in a similar position.

4. When all the resources of the country including those of the Union and the State Governments are being mobilised both for efficient administration and planned development, we do not feel justified either in providing large sums for contingent liabilities of the States or in making large financial provisions without adequate scrutiny for measures presented at the fag end of our work.

5. We are, therefore, unable to agree with the recommendations made by Shri Mohan Lal Gautam.

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ordinary revenues, i.e., revenues to which it would be entitled as of right. (ii) Nowhere in these articles is there an express or implied indication that the total revenues of a State should be utilised only for revenue expenditure. Indeed, it may be said that the more or less arbitrary division of expenditure into Capital and Revenue does not find a place as such in the Constitution, though the Constitution draws a distinction between grants of Capital and recurring sums and also between grants and loans. There is no indication either that the function of the Finance Commission is to be confined to the revenue part of the budgetary needs of a State. Article 275, which occurs in the same section relating to distribution of revenues between the Union and States, speaks of States which may be determined to be in need of assistance. It does not say 'assistance for filling up the revenue gap'. On the other hand, the two provisos to clause (i) of article 275 expressly refer to Capital and recurring sums to be paid as grants-in-aid of the revenues of a State. The first proviso unequivocally includes the costs of schemes of development as may be undertaken by the State. It is abundantly clear to my mind that the reference in the main part of clause (i) of article 275 to grants-in-aid of the revenues of States is not confined to revenue expenditure only.

7. It follows from a construction of the relevant articles of the Constitution, as they stand, that the Finance Commission is concerned with the total assistance to be given to a State, other than by way of loans, whether classified as capital or revenue. There is no legal warrant for excluding from the scope of the Finance Commission all capital grants; even the capital requirements of a State may be properly met by grants-in-aid under article 275(1), made on the recommendations of the Finance Commission.

8. It is the setting up of the Planning Commission that has in practice restricted the scope and functions of the Finance Commission. I say 'in practice' because there has been no amendment of the Constitution to confine the functions of the Finance Commission to merely ascertain and cover the revenue gap of each State, on a review of the forecast of Revenue and Expenditure furnished by the State. Apparently, even the view taken by the Government of India is not that it is beyond the power of the Finance Commission to provide for the requirements of the Plan. The third Finance Commission made a recommendation by a majority that the total amounts of grants-in-aid should be of an order which would enable the States, along with any surplus out of the devolution, to cover 75 per cent

of the revenue component of their plans. This recommendation, from which the Member-Secretary dissented, was not accepted by the Government of India, but not for the reason that the Finance Commission travelled beyond its sphere. The reason was more practical than legal. In their explanatory Memorandum on the action taken on the recommendations of the third Finance Commission, the Government of India only say that they do not consider it either necessary or desirable to accept the recommendation, to include 75 per cent of the revenue component of the State plans in the scheme of devolution recommended by the Commission, because there will be no real advantage in the States receiving assistance for their plans, partly by way of statutory grants-in-aid by the Finance Commission and partly on the basis of annual reviews by the Planning Commission.

9. The legal position, therefore, is that there is nothing in the Constitution to prevent the Finance Commission to take into consideration both Capital and Revenue requirements of the States in formulating a scheme of devolution and in recommending grants under article 275 of the Constitution. But, the setting up of the Planning Commission inevitably has led to a duplication and overlapping of functions to avoid which, a practice has grown up, which has resulted in the curtailment of the functions of the Finance Commission.

10. Evidently, the terms of reference to the Fourth Finance Commission have been formulated with the object of eliminating duality of functions between the Finance Commission and the Planning Commission. This is based apparently on the Government's decision that the two bodies should have separate and well-defined spheres of work. Unlike the terms of reference to the third Finance Commission (and the second Finance Commission also), there is no reference to the requirements of the Fourth Plan except in the matter of servicing of debt.

11. The grants for financing plans would be given on the basis of recommendations made by the Planning Commission and will not be left to be determined by the Finance Commission.

12. There is no provision in the Constitution for a body like the Planning Commission. It was established by a resolution of the Government of India. Neither the strength of the Commission nor the qualification of its members was prescribed. The Government retained complete freedom to vary its strength at will and to appoint

any one as a Member. There was no limit to the duration of the Commission. When it was constituted, possibly it was meant to be a temporary body and in a sense it continues to be so, though obviously it has come to stay. The composition of the Commission is unusual. It has, as its Chairman, the Prime Minister and among its Members, there are Cabinet Ministers. When compared to a statutory body like the Finance Commission, which is quite independent of the Government, the Planning Commission may be described as a quasi-political body. There has been from time to time variation in the strength of the Commission and in the appointment of its Members. Though its role is advisory, it has come to occupy a very significant and important place in the economic development of the country. *Vis-a-vis* the Government, it is not easy to describe its status in spite of its importance; it remains to this day a body without any constitutional or legislative sanction. As the entire plan, both as regards policy and programme, comes within the purview of the Planning Commission and as the assistance to be given by the Centre for plan projects either by way of grants or loans is practically dependent on the recommendations of the Planning Commission, it is obvious that a body like the Finance Commission cannot operate in the same field. The main function of the Finance Commission now consists in determining the revenue gap of each State and providing for filling up the gap by a scheme of devolution, partly by a distribution of taxes and duties and partly by grants-in-aid. Personally, I have no comment to make on such a dichotomy of functions. But, I think that the relative scope and functions of the two Commissions should be clearly defined by amending the constitution and the Planning Commission should be made a statutory body independent of the Government.

13. As capital grants for plan projects came to be excluded from the purview of the Finance Commission, it was necessary to find a constitutional provision to enable the Centre to make grants to the States to assist them in the implementation of their plan projects. Resort was made to article 282 of the Constitution, because grants under article 275(1) were to be made only for the purpose of closing the revenue gap.

14. I do not go to the extent of saying that article 282 does not confer power on the Union Government to make grants to the States for implementation of their Plans. The language is wide enough to cover such grants. But I have only one comment to make on the form of such grants. Article 282 contemplates a grant for a public

purpose. I doubt if grants under article 282 can be made without such grants being tied to a specific public purpose.

15. In my opinion article 282 was never intended for the purpose for which it is now being used. It is a substantial reproduction of Section 150(2) of the Government of India Act, 1935, except that while the Act of 1935 simply mentioned 'any purpose', the Constitution says 'any public purpose'.

16. In Chapter I, Part XII of the Constitution dealing with 'Finance', article 282 is the first of a series of miscellaneous financial provisions. There can be little doubt as to the purpose for which this article and the corresponding provision in the Govt. of India Act, 1935 were enacted. In this connection, it is important to notice that article 282 of the Constitution (and section 150 of the Government of India Act, 1935) mention both the Centre and the States. The language is singularly inappropriate for a special provision to enable the Union to make grants to the States. For a proper construction of article 282, reference must be made to article 266(3) of the Constitution, which says:—

"No moneys out of the Consolidated Fund of India or the Consolidated Fund of a State shall be appropriated except in accordance with law and for the purposes and in the manner provided in this Constitution".

17. It is a well recognised concept that the spending power of a State is co-terminus with its legislative power. It will be *ultra vires* for the Union to expend any money for a purpose not covered by the Union List or the Concurrent List and it will be equally *ultra vires* for a State to spend any money on a matter which is exclusively within the Union List. The real purpose of article 282 is to validate such expenditure either by the Union or a State. The Union or a State is of course entitled to make a grant for any purpose, provided it is a purpose which would fall within the respective sphere of either of them. But article 282 specifically empowers the Union or a State to make a grant for any public purpose, though that purpose is one which does not fall within the legislative ambit of the Union or the State respectively. Article 282 confers on the Union or a State a spending power without conferring legislative power. The marginal note gives a clue to the proper construction of the Article. It runs thus:—

"Expenditure defrayable by the Union or a State out of its revenues".

18. It is clear to my mind that article 282 was not intended to enable the Union to make a grant to a State as such. I venture to say that while article 282 may continue to stay for the purpose for which it was originally intended, a specific constitutional provision may be added to enable the Union Government to make conditional grants to States for implementation of any project, whether falling within or without the Plan scheme on terms and conditions which will ensure a proper utilisation of the grants.

19. After fifteen years of working the provisions of the Constitution, during which period four Finance Commissions have been appointed, I think the time is ripe to have a review of the Union-State financial relationship, particularly in view of the setting up of the Planning Commission. This review should be made by a special Commission who can approach the several problems that have arisen in the past and that are likely to arise in the future objectively and realistically. Some of the questions which may fall to be decided by this Commission, I shall mention briefly:—

(1) The scope and purpose of grants under articles 275 and 282 of the Constitution may be clarified and defined. A dual scheme of transfer of resources from the Centre to the States should completely avoid duplication and overlapping. If need be, a separate provision in the Constitution may be added, apart from article 282, which I pointed out, earlier on, was not intended for that purpose, to enable the Central Government to make grants for implementation of plan and non-plan schemes, imposing terms and conditions to ensure a proper utilisation of the grants. Such grants may be made after considering the recommendation of a body like the Planning Commission. I only venture to suggest that the Planning Commission may be given the status of an independent permanent statutory body.

(2) A scheme may be devised to avoid uncertainty and speculation as to the allocation of divisible taxes and duties like Income-tax and excise duties. Several States have pleaded before successive Finance Commissions for varying proportions of allocation, some going to the extent of an allocation of 100 per cent. to the States in the case of income-tax proceeds. A definitive allocation by way of percentages of shares of the Union and States respectively may be fixed by the Constitution itself.

20. As regards distribution *inter se* among the several States, the general principles and criteria may be laid down by the Constitution. Here again, there has been a great divergence in the sugges-

tions put forward by the States before the Finance Commissions. Population, contribution, collection, relative financial weakness, social and economic backwardness, *per capita* income are some of the different criteria urged by one or other of the States. In respect of such an important matter as the determination of the resources which will be available to each State as a result of a scheme of devolution, there should not be a gamble on the personal views of five persons, or a majority of them. I say this without intending any disparagement of the eminence, equipment and impartiality of the Members of the Commissions. After all these provisions are made in the Constitution what remains is an examination of the forecasts of Revenue and Expenditure made by the States to determine the grants-in-aid of the revenues to such States as may be necessary under article 275(1). This task may be assigned to a Finance Commission, or to a consultative institution, such as we have recommended in the Report, or to a wing of the Planning Commission itself. Periodical reviews by an independent Commission would guarantee justice to the States and the continuation of such a Commission is an essential feature of our Constitution.

21. A suggestion similar to mine for a review of the constitutional provisions dealing with financial relations between Union and States is to be found in the reports of both the second and third Finance Commissions.

22. There is one other matter which is not directly covered by the terms of reference, but on which I would like to express my personal view. Representations have been made to us that with reference to a number of commodities subject to Union excise duties, additional excise duties in lieu of sales tax may be substituted. It was pointed out that this would simplify the problem of collection and make the incidence of tax burden uniform and may have the effect of stepping up production and distribution. Such a course may not find favour with the States on the ground that sales tax is their only available elastic source of revenue. This objection may, however, be met by giving the States a larger share of the receipts from the basic excise duties and any special duties of excise or surcharges on the duties. A view has been expressed that if it were possible to make a constitutional amendment, placing the yield of excise duties on the same footing as income-tax, there might be just a possibility of the States agreeing to the merger of sales taxes and excise duties.

## MINUTE BY PROF. BHABATOSH DATTA

The Report we have presented recommends an integrated scheme of devolution and grants-in-aid based upon the general principles we have formulated in Chapter II. The field covered by these recommendations is defined by the relevant provisions in the Constitution and our terms of reference. I have felt, however, that there are certain allied questions which deserve urgent consideration at the present stage, in view of the changes that have been taking place in our economic and financial situation since the introduction of the present system of Union-State financial relations. The following paragraphs seek to indicate some of the very important problems that have already arisen and are likely to become crucial in the not very distant future.

2. The principles of devolution of taxes adopted in this Report and the resulting scheme of distribution have led to surpluses for some States and deficits neutralised by grants under article 275 for others. In a few cases, the surpluses are substantial and, similarly, there are cases in which the deficits and the consequential grants are quite large.

3. The surpluses do not create any problem, because these amounts will be taken into account in determining the sizes and patterns of the State Plans. In the case of the deficit States, however, while there should be no difficulty regarding the Plan outlays if the Central assistance for Plan purposes is appropriately adjusted, there will remain the difficulties and problems arising from the dependence of their normal revenue budgets on large grants-in-aid. Apart from the adverse psychological effects of such large grants, both to the giver and to the taker, there is the fact that a relatively large grant element in the total amount of transfer to a State deprives that State, relatively to others, from the benefit arising from the buoyancy of the Central revenues.

4. The position created by the devolution scheme recommended by us is the unavoidable result of the constitutional provisions as they stand now. The position would not have been very much different even if any other alternative principle of devolution (within the framework of the Constitution) had been adopted, including the schemes recommended by the earlier Commissions. In fact,

there is one State which would have got a large surplus, even if the shares of income tax and Union excises allotted to it were only nominal. At the other extreme, there is another State which would still have experienced a large deficit (requiring a large grant-in-aid) even if disproportionately large transfers were made to it out of the income tax and Union excise receipts.

5. If a change in the distribution of functions between the Union and the States is ruled out, the situation can be remedied by widening the base of tax-sharing, i.e. by including a larger number of items in the devolution scheme. With a number of sharable taxes, it will be possible to devise a scheme which will involve a uniform principle for each sharable tax but different principles for different taxes, making the whole scheme of distribution more flexible than it is now. Many States suggested that the receipts from the Corporation Tax should be divided between the Centre and the States. Some of them argued, with some force, that if estate duty receipts from property other than agricultural land are divisible, the same logic should make the receipts from the gift tax also sharable: A plea has often been made to include expenditure tax in the divisible pool, because, basically, this tax and income tax together represent an integrated method for securing progressive contributions from rising incomes.

6. We could not recommend any positive step in this regard within our terms of reference which, in their turn, are circumscribed by the provisions of the Constitution as they exist now. It is, however, difficult to ignore the fact that the fifteen years that have elapsed since the adoption of the Constitution have seen very large changes in the economic and financial background on which the original provisions regarding the Union-State financial relations were based. It is time now to re-examine the whole scheme of devolution without excluding from the purview of such re-examination the possible need for changes in the Constitution.

7. The need for widening the base of devolution is imperative not only for enabling the Finance Commission and the Government of India to devise and adopt a more flexible scheme of devolution than is possible now, but also because of the rate of increase in the financial requirements of the States *vis-a-vis* the prospects of revenues from the two major divisible taxes under the present Constitution. The requirements of the State Governments are increasing rapidly because of the increasing numbers that have to be served by the social services (particularly education and health),