

any substantial increase in these rates will be practicable in the future. One also notes that one of the items in our terms of reference indicates that the Union Government is disturbed over the combined incidence of the Central excise duties and the States' sales taxes on production, consumption and export. We have stated in the Report that we do not find it possible to apportion the effects of these two categories of taxes on production, consumption or export and we accordingly do not recommend the linking-up of the States' shares of the Union excise proceeds with the levels of their sales taxes. But if the Centre wants at all to persuade the States to keep their sales tax rates at a moderate level, it will have to be cautious about increasing the Union excise duties.

15. Increase in the Union excise revenues resulting from rise in prices will be naturally small, because most of the duties are, and have to be, specific, rather than *ad valorem*.

16. The only dependable growth factor in the future Union excise revenues is the prospective increase in the outputs of the excisable commodities. While it should be expected that the outputs will increase—presumably at higher rates than in the past—it would appear that the growth of excise revenues on account of this factor alone cannot continue to be as great as the past growth rates which were brought about by a combination of this factor with certain other very active factors which are not likely to continue with equal effectiveness in the future.

17. The conclusion that emerges is that the total receipts from income tax and the Union excises are not likely to increase at a rate fast enough to match the rate of increase of the States' normal essential expenditures. It may be argued that the percentage shares allocated to the States out of these two sources may be increased further in the future years. It should however be realised that in the case of income tax, if the States' share in the divisible pool is raised to 75 per cent as recommended by us, the scope for further increase in the share will be very limited under the present provisions of the Constitution defining the divisible pool. In the case of the Union excises, there would theoretically be a large scope to increasing the share of the States above the 20 per cent recommended by us, but any set of uniform principles adopted for all the States will mean that the additional amounts to be shared will go largely not to those States which will require financial assistance, but to those which even otherwise will have large surpluses.

18. All this emphasizes the suggestion made earlier that it is now time to re-examine the provisions of the Constitution with a view to ensuring a more flexible devolution scheme than is possible now. In this connection one might also refer to the existing provisions in article 269 regarding certain specified taxes which are to be levied and collected by the Union Government, but the proceeds of which are to be wholly assigned to the States. At present, the only tax in this category that is being levied and collected by the Union is the estate duty on property other than agricultural land (The Central Sales Tax also comes under article 269, but it belongs in effect to a different category). The total receipts from the estate duty are still small, but the potentialities are large, though not large enough to compensate for the relative decline in the importance of income-tax proceeds. A railway fare tax introduced in 1957 was merged with the fares four years later, with the result that the States ceased to have a statutory claim on the receipts. As things stand now, a mere terminological change can prevent the division of the receipts from a particular source between the Centre and the States, or can make a purely Central revenue a divisible one. A ten per cent increase in the amounts payable by railway passengers for their tickets will create divisible resources, if designated as a "tax on fares", and will create resources for the Centre only, if designated as an "increase in fares". The distinction between a tax on the output of a Government enterprise and an increase in its price is extremely tenuous, and it is desirable that in such cases action should be taken on the lines which are consistent with the spirit of the Constitution, unless the constitutional provision itself is changed. This is particularly important because article 269 has been very inadequately exploited up till now and because if it has to be exploited at all to produce significant revenues for the States, the only two items that have a good potentiality are the terminal taxes on goods and passengers and the taxes on railway fares and freight.

19. It is necessary to emphasize here that the suggestions made above need not necessarily mean a larger total of transfers to the States than under the present arrangements. But, in view of the expanding requirements of the States, it is desirable to be prepared for larger transfers. The justification for the widening of the base of devolution arises from this as well as from the need for a system which would make the distribution scheme more flexible and would make it possible for the future Finance Commissions to devise their

the widening of the range of their functions in the economic field and the rapidly growing commitments for the maintenance of the completed Plan schemes. One can, of course, anticipate a high rate of growth in the States' receipts from Sales Tax and a few other taxes of a similar nature, but it is the elasticities of the aggregate revenue receipts and expenditures that will be really important.

8. The contribution of the divisible taxes other than income tax and Union excise duties to the meeting of these requirements of the States has been very small up till now and is not likely to increase appreciably in future. What is more disturbing is that even the two major heads in the present scheme of devolution cannot be necessarily expected to expand at the rate at which the States' normal expenditures are increasing.

9. This is already patent in the way in which the role of income tax in the devolution scheme has changed. Income tax was a "divided head" before 1919, and even in the rigidly demarcated separation of heads under the Government of India Act of 1919, a marginal provision was made for returning to the provinces a small fraction of the receipts in excess of a base-year figure. The Government of India Act of 1935 gave the Provinces a statutory share of the income tax receipts. It was, however, indicated that a fifty per cent share would be sufficient and that, in the initial years, the provinces would be able to afford the retention by the Centre of a further amount out of the fifty per cent to be transferred. The linking of the total effective Central share of the income tax proceeds with the railways' contribution to the general revenues under the Niemeyer Award was the direct result of this. Income tax was taken as the major balancing factor and it was thought that a sum of five or six crores of rupees out of its proceeds would adequately balance the provinces' budgets.

10. The provision made in the Constitution of 1950 regarding the allocation of income tax was in line with the ideas that had been evolved earlier. It was still regarded as the major balancing factor. The provision regarding the sharing of the Union excises was only permissive and not mandatory and the taxes specified under article 269 were clearly State taxes—not entering at all into the Consolidated Fund of India—which, in the interests of uniformity and convenience, the Centre would raise on behalf of the States.

11. It has by now become obvious that the importance of income tax proceeds as a balancing factor has declined—partly because of

the changes in the structure of this and other allied taxes and partly because of the changes in the dimensions of the problem of devolution. The change introduced in the income tax law in 1959 regarding the classification of the tax on the incomes of joint stock companies seriously affected the rate of growth of the distributable income tax receipts. There have recently been other inhibiting factors like the introduction of new imposts like Compulsory Deposits and Annuity Deposits which are directly based on the incomes of the tax-payers and which, therefore, compete with the ordinary income tax. It is not implied that these imposts are undesirable, but one has to note the present and potential effects of such imposts on the revenues from the income tax proper and, therefore, on the States' revenue receipts.

12. The relative decline in the importance of the income tax proceeds as a balancing factor, *vis-a-vis* the expanding requirements of the States compelled the successive Finance Commissions to bring the excise duties on an increasing number of commodities into the divisible group. We have recommended that all commodities on which excises are levied by the Government of India should be included in the devolution scheme and this was also the principle behind the recommendation of the Third Finance Commission. Even in the case of the Union excises, however, one can discern factors which are likely to lead to a decline in the rate of growth of receipts. The actual experience up till now has been that of a very high rate of growth, but this has been due to a combination of factors all of which cannot be expected to continue to operate equally actively in the coming years.

13. The very high rate of growth in the Union excise receipts in the last fifteen years has been due to, first, increases in the number of commodities taxed; secondly, increases in rates; thirdly, rise in prices; and fourthly, increases in the outputs of the taxable commodities. The growth of excise revenues on account of increase in the number of commodities taxed cannot continue at a rapid rate, when practically all the commodities likely to yield large revenues have already been brought under the scope of this levy. There are, in fact, certain excise duties yielding very small revenues, and it may become desirable to eliminate some of them from the excise schedule.

14. To the extent that the growth of revenues results from changes in the rates of taxation, one notes that the rates on most of the commodities are already fairly high and it is doubtful whether

schemes in such a way as to avoid at least very large deficits and very large grants in the case of some States.

20. There is one other point to which I would draw attention before concluding. This relates to the expenditure which may become necessary from time to time for the revision of pay scales or dearness allowances of State Government employees and of those private employees whose salaries and dearness allowances are largely paid out of the State Governments' funds. The most important class of employees coming under the latter category are teachers in private schools and colleges. There are substantial inter-State disparities in pay scales and allowances and the State scales are generally lower than those of the comparable Central Government employees. There is, besides, the very important problem of the adjustments that may be required periodically to neutralise the effects of increases in the cost of living.

21. The resources of the State Governments have not generally proved adequate for the revisions and adjustments they have considered necessary. The forecasts submitted to the Finance Commission by practically all States included the estimated expenditure on a number of proposals for revision both for State Government employees and for teachers. It was, however, difficult for the Finance Commission to constitute itself into a pay revision body and it could therefore take into account only those revisions which had actually been accomplished and on account of which a financial commitment had already been created before the finalisation of its Report. This position which, in the circumstances, was the only one that the Commission could take, resulted in the unedifying experience of several State Governments racing against time to present their finalised decisions before the expiry of the term of office of the Commission.

22. It will not be surprising if there are complaints from those States which could not or did not enter the race. What is more important is that this is an entirely unsatisfactory way for dealing with a problem of great importance. The problem of the salaries of the State Government employees and of teachers and others who are largely paid out of the State Government funds is part of a bigger problem, involving not only the question of inter-State parity or parity with the incomes of the Central Government employees, but also the general incomes policy for the country as a whole. This is becoming increasingly important on account of the pressures that are operating

on the economy on the one hand and the need for at least maintaining the real value of the incomes of all types of employees on the other.

23. It is essential, therefore, to have some arrangement for a continuous examination of the problem of incomes, both in its inter-regional and inter-temporal aspects. Such examination would in the very nature of things cover the question of the incomes of Government employees and of those who are paid partly or wholly, out of Government funds. There should similarly be some arrangement by which the financial requirements of the State Governments in this regard would be examined jointly by the Centre and the States at frequent intervals. The Finance Commission cannot itself undertake the task of determining what should be the appropriate rates of pay and allowances, but revision by hectic spurts at five-yearly intervals, with the Finance Commission playing a passive role, may produce results which are unsatisfactory to the employees, inequitable as between States and injurious for the economy as a whole. A permanent and continuously operating machinery is needed for the purpose.

NEW DELHI;

Dated August 12, 1965.

BIHABATOSH DATTA

Member.

Annexure 1.

ITEMS NOT INCLUDED IN THE ASSESSMENT OF EXPENDITURE

Part 1: Proposals on which final orders have not been issued pending the reports of a Commission or Committee or passing of an Act by the Legislature (vide para. 128, Chapter 10).

States	Scheme or item of expenditure	Remarks
1. Assam	Special requirements of hill districts.	The proposals are under consideration of the State Government and the report of a Committee appointed by the Government of India is awaited.
2. Madhya Pradesh	Improvement and strengthening of Police organisation.	The Commission appointed by the State Government is yet to make its recommendations.
3. Mysore	Grants to Panchayats	A Panchayat Bill providing for the grants introduced in the legislature in January 1965 has been referred to a Joint Select Committee.

Part 2: Government Orders not taken into account in the assessment (vide para. 129, Chapter 10).

States	Government order, date of issue and subject.	Liability estimated by State Government.
1. Andhra Pradesh	G.O.M.S. No. 169 dated 1st July, 1965 revising the rates of Dearness Allowance on the basis of an interim report by one man Pay Commission.	Rs. 6.80 crores for the first year and Rs. 37.40 crores for the Fourth Plan period.
2. Mysore	G.O. No. FD 76 SRP (i) 65, dated 22nd July, 1965 revising the rates of dearness allowance.	Rs. 2.74 crores for the first year and Rs. 14.76 crores for the Fourth Plan period.
3. Uttar Pradesh	G.O. No. G-I-1474/X-137—1965 dated July, 29, 1965 regarding rationalization of pay scales of Govt. servants effective from 1-4-1965 and revision of City Compensatory allowance and other allowances effective from 1-8-1965.	Rs. 15.12 crores for the first full year.

States	Government Order, date of issue and subject.	Liability estimated by State Government.
3. Uttar Pradesh— contd.	Orders No. C-II/4787-91/XV, dated 27th July, 1965 regarding <i>Ad hoc</i> increase in emoluments to the teaching and non-teaching staff, staff of educational institutions and Universities; Revision of pay of teachers and grant of D.A. to employees of non-Government Training Colleges and schools.	Rs. 6.40 crores for the first full year.