CHAPTER 5

DEVOLUTIONS AND GRANTS FOR 1969-70

57. The Commission has been asked in paragraph 6 of the Presidential Order to make an interim Report, in particular in respect of the financial year 1969-70. In that connection, we obtained from the State Governments forecasts of their revenue receipts and expenditure for that year. We requested them to furnish particulars of their revenue receipts on the basis of the levels of taxation likely to be reached at the end of 1968-69, exclusive of devolutions of taxes and grants. On the expenditure side, we requested them to furnish details of their expenditure on revenue account including the maintenance of Plan schemes completed by the end of 1968-69, but exclusive of the requirements of the Fourth Five-Year Plan.

58. After a preliminary scrutiny of the forecasts furnished by the State Governments, we had discussions with their representatives on various dates from the 17th June to the 23rd August, 1968. These discussions revealed the necessity for obtaining additional information on a number of points, which the representatives of the State Governments were asked to furnish. We have not yet received complete information on these points from all the States.

59. In respect of devolutions of taxes and duties, we decided that for the purpose of the interim Report we would take up, for making final recommendations, only the distribution of the net proceeds of estate duty and the grant in lieu of the repealed tax on railway passenger fares. Our discussions with the States in regard to distribution of taxes and duties were confined to these two matters. Our recommendations on them are given in Chapters 2 and 3 of this Report and they cover the period from 1969-70 to 1973-74.

60. In their forecasts for the year 1969-70 the States have shown that on the basis of their own revenue receipts, they would have revenue deficits aggregating to Rs. 1,283·69 crores. If the transfer of funds to the States by way of devolutions of taxes and duties and grants under Article 275 (1) of the Constitution are continued during 1969-70 on the existing basis, the States would still have uncovered deficits of about Rs. 650 crores, and every State would continue to have a deficit. Obviously, it is not possible to make additional transfers of funds of this magnitude to the States. It is, therefore, necessary to examine the forecasts furnished by the State Governments very carefully in order to assess their reasonable requirements.

61. The States' forecasts vary considerably in the methods and patterns adopted in regard to matters like reduction or avoidance of debt, earmarking of funds for special purposes, treatment of items like trading profits or losses, and classification between non-Plan and

does not persistently follow policies resulting in financial difficulties and that the Central Government cannot clear unauthorised overdrafts repeatedly.

(Para 53)

(17) For this purpose the Government of India should, as soon as it is informed by the Reserve Bank about issue of notice to the State, ascertain from the State what steps it proposes to take to clear the overdraft. If the State Government is not in a position to clear the overdraft it should urgently approach the Central Government for special assistance. The Central Government should, where it decides to assist the State, release in advance the State's share of devolution or Plan assistance payable during the year. When the amount due to the State during the year is not sufficient for the purpose, further assistance should be given as an *ad hoc* loan to be adjusted against the devolution or Plan assistance falling due during the next year.

(Para 53)

(18) The Central Government should also have consultations with the State Government to ascertain the causes of its difficulties and to ensure that the situation does not recur. It should depute a team of its officers, including a nominee of the Planning Commission, to visit the State for assessing the situation and recommending remedial action, and also considering whether any further temporary loan assistance is necessary for tiding over the immediate difficulties of the State.

(Para 54)

(19) The Central Government should call upon the State to adopt such measures as it may deem necessary. For the purpose of securing effective control over expenditure so as to keep it within actual receipts, it should be open to the Central Government to nominate an officer to be associated with the Finance Department of the State. The State Government should complv with these requirements.

(Para 54)

(20) If a State Government persists in incurring an unauthorised overdraft it would not be proper that the Central Government should clear it and the consequences of failure to clear it will have to be faced. In such a case, or where an overdraft cannot be cleared in accordance with the procedure we have suggested, the Central Government would have to take a view whether the crisis resulting from stoppage of Payments of the States' cheques should be allowed to develop or it would be expedient to forestall it by invoking its Constitutional powers.

(Para 55)

Plan expenditure and between revenue and capital accounts. These forecasts, therefore, require to be suitably adjusted so as to put them on a comparable basis. Our terms of reference also require us to have regard to the scope for better fiscal management and for economy consistent with efficiency in State expenditure. Several States represented to us that it would be highly inequitable to disallow items of fresh expenditure, only on the ground that the relevant decisions were not made before a particular date. Some States have urged that their tax efforts and measures adopted for effecting economy should be given due consideration by the Commission in framing its recommendations. Some of them have represented that they should not be made to suffer in comparison with other States which have shown larger deficits due to adoption of policies resulting in reduction of their revenues or large increases in their non-Plan expenditure. They have, therefore, urged that some suitable norms should be evolved regarding tax effort, administrative expenditure, levels of services and the economic working of commercial undertakings. Some States have, on the other hand, suggested that the Commission should take into account the actual levels of taxation in 1968-69 and should give due consideration to all their commitments of expenditure as well as their requirements for fresh expenditure, in determining their need for assistance. These questions require careful consideration before a proper assessment of the needs of the States can be attempted.

62. The Fourth Finance Commission had, in their assessment of revenue expenditure, included provision for amortisation of market loans to the extent to which various States were actually making such provision in their annual budgets. This resulted in varying benefits to the States, as they were not making such provisions on a uniform basis. We understand that a proposal to provide additional assistance to such States as were not making adequate provision to amortise their market borrowings, is under the consideration of the Government of India in order to place all the States on a uniform basis. From the material furnished to us it appears that the sums provided for amortisation in the States' budgets were in many cases not being kept invested in a suitable form so as to be available for meeting the repayment of the loans, but were being utilised for other expenditure. The State Governments have, in their forecasts for 1969-70, included larger provisions under amortisation of market borrowings and loans from the Central Government than what they have been making in their budgets hitherto. The question regarding the basis on which amortisation of different types of loans should be made and the extent to which it should be provided for in the revenue budget, requires detailed examination.

63. The Fourth Finance Commission had assessed the needs of the States after disallowing losses from enterprises managed departmentally by the State Governments and assuming full receipt of interest on loans to autonomous corporations. Some State Governments represented to us that the costs of generation and distribution of electricity were so high that it was not practicable to make the working of their State Electricity Boards economic on the basis of any reasonable tariffs. Further, they stated that rural electrification

schemes could not be expected to be self-supporting for a number of years and they had to be subsidized meanwhile. It was also stated that in view of the low priority assigned to payment of interest on loans from the State Government under the provisions of the Electricity (Supply) Act, 1948, substantial amounts of investment made on power schemes could not bring actual receipts of interest to the States for a long time. The State Governments, therefore, criticised the assumptions made by the Fourth Finance Commission in this regard as being unrealistic and unfair to them. Further, there is the question of returns from irrigation projects and investments in other commercial enterprises. These matters have an important bearing on the finances of the States, and have to be carefully considered.

64. Under the Presidential Order, we have been asked to have due regard to the resources of the Central Government and demands thereon on account of expenditure on civil administration, defence and border security, debt servicing and other committed expenditure and liabilities. For this purpose, we asked the Ministry of Finance to send us the forecast of the Central Government's receipts and expenditure on revenue account for the year 1969-70. We find that the estimated surplus on revenue account falls very much short of the total estimated deficits of the States on non-Plan revenue account.

65. In view of the overall inadequacy of the total revenue resources in relation to the aggregate requirements of expenditure of the States as well as the Centre, as estimated by them, the question of determining the size of total transfer of funds from the Centre to the States as well as the assessment of the needs of the States on a reasonable and equitable basis, become matters of great importance. We consider that it would not be proper to take any final view on these matters on the basis of forecasts for the year 1969-70 only. Any view taken on such matters for that year will inevitably have far-reaching effects on the assessments relating to subsequent years regarding which we have to make recommendations.

66. We have not received the forecasts for the period of five years from all the States or from the Centre. We have also not yet taken up for detailed consideration the question of sharing of proceeds of income-tax and Union excise duties between the Centre and the States, or the principles of distribution of the States' shares of these taxes as well as proceeds of additional excise duties. We can, therefore, for the present only make interim recommendations for meeting the immediate requirements of the States for 1969-70 on a provisional basis.

67. In any interim recommendations to be made for the year 1969-70, pending the final assessment of the States' requirements, it would be necessary to continue provisionally the devolutions of taxes and duties as well as the grants under Article 275 on the existing basis. The estimated amount of transfer of funds to the States on this basis would exceed the amount included in their budget estimates for 1968-69 by about Rs. 55 crores. We proceeded to examine whether the immediate requirements of all the States would be met thereby.

68. We find that the States have to meet substantial additional expenditure on account of certain factors which have arisen during the last three years. The grants given by the Central Government for Plan schemes completed during the years 1966-67 to 1968-69 will cease with effect from the 1st April, 1969. But large amounts will have to be provided by the States as 'committed' expenditure for the continuance of such schemes as well as the maintenance of capital works completed under the Plan during these three years. Further, the increases in dearness allowance which the States have had to give to their employees during this period have placed substantial burdens on their revenue budgets. The interest charges have also increased more than anticipated.

69. We considered carefully the basis on which we could proceed to determine the immediate requirements of the States for the year 1969-70. The basis that we decided to adopt was the assessment of the States' requirements for cash expenditure on revenue account. The only exception made in this regard was to allow for provision for expenditure relating to natural calamities, to the same extent as was allowed by the Fourth Finance Commission. We then made a preliminary examination of the States' forecasts for 1969-70 and compared them with the budget estimates for 1968-69. For this purpose, the forecasts for 1969-70 as well as the budget estimates for 1968-69 were first adjusted by excluding certain non-comparable items. After making these adjustments we found that the remaining non-Plan revenue expenditure provided for in the States' forecasts exceeded the corresponding expenditure in the budget estimates for 1968-69 by about 14 per cent for all the States taken together. On the other hand, in regard to the revenue receipts, after adjustment on a comparable basis, the States' forecasts for 1969-70 were lower than the corresponding receipts shown in their budget estimates for 1968-69 by about 3 per cent. In view of this position, we considered that the budget estimates for 1968-69 with suitable adjustments would provide a more appropriate basis for making our assessment of the States' cash requirements on revenue account during 1969-70.

70. The States' budget estimates for 1968-69 required suitable adjustments before they could be adopted as the basis for projection for the purpose of arriving at the assessed estimates for 1969-70. On the expenditure side, we decided to make an addition to the budget estimates of an amount of 5 per cent of the provision for expenditure of a standing nature. The remaining provisions which were not of a standing nature were dealt with separately. For this purpose the provisions for Plan schemes were deducted and the estimates were reduced to cash basis by excluding the provisions for amortisation of debt assumed by the State Governments. The estimated expenditure on natural calamities was also reduced to the level assumed by the Fourth Finance Commission. In the case of certain items where provision had been made in the budget estimates for 1968-69 and where the expenditure has been or is likely to be discontinued during the current year, such provision was excluded. Suitable provisions were added in respect of committed expenditure, additional liability for interest on public debt including the interest on likely fresh public borrowings during 1969-70, and increases in dearness allowance over the levels provided for in the budget estimates for 1968-69.

71. In regard to the committed expenditure, the forecasts given by the States were adopted as the basis. But where the State's forecast of such expenditure in 1969-70 worked out to a higher percentage of the revenue Plan outlay for 1968-69 than the percentage of the committed expenditure in 1966-67 to the revenue Plan outlay in 1965-66, the provision was limited to the latter percentage after increasing it by 20 per cent thereof. This increase was provided to cover any variations in the pattern of completed Plan schemes. The States' forecasts in respect of interest on loans advanced by the Central Government were adjusted to correspond to the estimates furnished by the Central Government. In regard to interest on other loans, we adopted the estimates in the States' forecasts.

72. On the receipts side, the States' budget estimates for 1968-69 were first adjusted by deducting the estimates of the States' shares of taxes and duties, grant in lieu of the tax on railway passenger fares, grants under Article 275 and Plan grants. In the case of States which had proposed taxation measures during 1968-69 but had not included the estimated receipts in the budget estimates, we added the estimated annual yield from such measures on the basis of the latest information furnished by the States. We also added 5 per cent of the receipts from the States' own resources for the purpose of projecting the estimates to the year 1969-70. The projected estimates of the States' own resources together with non-Plan grants at the same level as in 1968-69 were taken as the assessed revenue receipts for 1969-70.

73. While making our provisional assessment of the revenue receipts as well as expenditure for 1969-70, we have projected the estimated figures for 1968-69 by adding 5 per cent in each case after excluding certain non-comparable items. We wish to make it clear that this rate has been adopted only as a reasonable working basis for making the provisional projection for 1969-70 and it does not represent our final view regarding the rates of growth which may be appropriate for different categories of receipts or expenditure.

74. In their forecasts for 1969-70, the States have included provisions for incurring fresh expenditure on several items like increase in pay and allowances of their employees due to general schemes of pay revision, strengthening their administrative machinery including the Police, improvement of educational and medical facilities and better maintenance of roads, buildings and other public works. We appreciate that many of these requirements for increased expenditure are *prima facie* reasonable, and all the States may not be able to provide for them from their existing resources. However, the nature of these requirements and their magnitude show considerable variations as between different States and they have to be examined from the view-point of existing levels of expenditure in different States, for which further discussions with the States are necessary. They have further to be considered in the perspective of the requirements of the whole period of five years, having regard to the limited overall resources available on the present basis and the scope for

additional efforts by the States themselves to increase their resources. We have not, therefore, at this stage taken into account any proposals for fresh expenditure, except additional requirements for dearness allowance and interest on market loans to be raised in 1969-70.

75. On this basis we find that after taking into account the States' own resources as well as the estimated transfer of funds to them in accordance with our recommendations in Chapters 2 and 3, and the continuance of devolutions of taxes and duties and the grants under Article 275 on the existing basis, some of the States will still be in need of further assistance in the year 1969-70. In making our recommendations regarding the sums to be provided as grants-in-aid of the revenues of the States under Article 275(1), we have taken into consideration the needs of such States for further assistance.

76. Accordingly, we make the following recommendations in respect of the financial year 1969-70:—

(a) The percentage of the net proceeds of income-tax assigned to the States as prescribed at present be continued in that year and be distributed among the States in the same manner as at present;

(b) The sums payable to the States in respect of their shares of the net proceeds of Union duties of excise be determined in the same manner as at present and be distributed among the States in accordance with the existing law;

(c) The net proceeds of additional excise duties leviable under the Additional Duties of Excise (Goods of Special Importance) Act, 1957, on the following commodities be distributed among the States in accordance with the existing law:—

(i) cotton fabrics

(ii) silk fabrics

(iii) woollen fabrics

(iv) rayon or artificial silk fabrics

(v) sugar, and

(vi) tobacco including manufactured tobacco.

(d) The sums specified below be paid in that year as grants-in-aid of the revenues of the following States under Article 275(1) of the Constitution:—

State	Sum to be paid as grant-in-aid (Rs. crores)
Andhra Pradesh	16·81
Assam	19·90
Bihar	3·42
Jammu & Kashmir	12·02
Kerala	20·82

State	*Sum to be paid as grant-in-aid* (Rs. crores)
Madhya Pradesh	9·36
Madras	6·84
Mysore	20·82
Nagaland	10·88
Orissa	29·18
Rajasthan	9·67
Uttar Pradesh	9·85
West Bengal	7·24
TOTAL	176·81

and (e) The amounts payable to the States in accordance with the recommendations contained in clauses (a) to (d) of this paragraph be treated as provisional and subject to re-adjustment on the basis of such recommendations as may be made in our final Report.

77. The position regarding the estimated amounts of transfer of funds to the States by way of their share of taxes and duties and grants under Article 275 (1) in the year 1969-70 in accordance with the recommendations made in this Report, as compared with the amounts of such transfers in 1968-69 based on the State Governments' budget estimates, is shown in Appendix IV.

MAHAVIR TYAGI,
Chairman.

P. C. BHATTACHARYYA,
Member.

M. SESHACHELAPATI,
Member.

D. T. LAKDAWALA,
Member.

V. L. GIDWANI,
Member-Secretary.

NEW DELHI,
October 31, 1968.