

# CHAPTER I

## INTRODUCTION

The Commission was constituted by an Order dated 23rd June 1977 of the Vice-President acting as President. The Order is reproduced below:—

"In pursuance of the provisions of article 280 of the Constitution of India and of the Finance Commission (Miscellaneous Provisions) Act, 1951 (33 of 1951), the Vice-President acting as President is pleased to constitute a Finance Commission consisting of Shri J. M. Shelat, former Judge of the Supreme Court of India, as the Chairman and the following four other members namely:—

- (1) Dr. Raj Krishna,  
Member, Planning Commission.
- (2) Dr. C. H. Hanumantha Rao,  
Director, Institute of Economic Growth,  
Delhi.
- (3) Shri H. N. Ray,  
Finance Secretary,  
Government of India.
- (4) Shri V. B. Eswaran - Member-Secretary.

2. The Chairman and other members of the Commission shall hold office from the date on which they respectively assume office upto the 31st day of October, 1978.
3. The Chairman and Member-Secretary of the Commission shall render whole-time service to the Commission. Dr. Raj Krishna and Dr. Hanumantha Rao shall render part-time service as members of the Commission. Shri H. N. Ray will render part-time service upto the 30th June, 1977 and whole-time service thereafter.
4. The Commission shall make recommendations as to the following matters:—
  - (a) the distribution between the Union and the States of the net proceeds of taxes which are to be, or may be, divided between them under Chapter I of Part XII of the Constitution and the allocation between the States of the respective shares of such proceeds;
  - (b) the principles which should govern the grants-in-aid of the revenues of the States out of the Consolidated Fund of India and the sums to be paid to the States which are in need of assistance by way of grants-in-aid of their revenues under article 275 of the Constitution for purposes other than those specified in the provisos to clause (1) of that article.

5. In making its recommendations, the Commission shall have regard, among other considerations, to—
- (i) the resources of the Central Government and the demands thereon on account of the expenditure on civil administration, defence and border security, debt servicing and other committed expenditure or liabilities;
  - (ii) the existing practice in regard to determination and distribution of Central assistance for financing State Plans;
  - (iii) the revenue resources of those States for the five years ending with the financial year 1983-84 on the basis of the levels of taxation likely to be reached at the end of the financial year 1978-79 and the targets set for additional resource mobilisation for the Plan;
  - (iv) the requirements on revenue account of those States to meet the expenditure on administration and other non-Plan commitments or liabilities, keeping however in view national policies and priorities. In assessing such requirements, the Commission shall take into account —
    - (a) such provision for emoluments of Government employees, teachers and local body employees as obtaining on a specified date as the Commission deem it proper and with reference to appropriate objective criteria rather than in terms of actual increases that may have been given effect to; and
    - (b) commitments in regard to interest charges on their debt, transfer of funds to local bodies and aided institutions;
  - (v) adequate maintenance and upkeep of capital assets and maintenance of Plan schemes completed by the end of 1978-79, the norms, if any, on the basis of which specified amounts are allowed for the maintenance of different categories of capital assets and the manner in which such maintenance expenditure could be monitored being indicated by the Commission;
  - (vi) the requirements of States which are backward in general administration for upgradation of standards in non-developmental sectors and services with a view to bringing them to the levels obtaining in the more advanced States over the period covered by the Report of the Commission; the manner in which such expenditure could be monitored, being also indicated by the Commission;
  - (vii) the scope for better fiscal management and economy in expenditure consistent with efficiency; and
  - (viii) the need for ensuring reasonable returns on investments in irrigation and power projects, transport undertakings, industrial and commercial enterprises and the like.
6. The Commission may suggest changes, if any, to be made in the principles governing the distribution among the States of:—
- (a) the net proceeds in any financial year of estate duty in respect of property other than agricultural land;

(b) the net proceeds in any financial year of the additional excise duties leviable under the Additional Duties of Excise (Goods of Special Importance) Act, 1957, in replacement of the sales tax levied formerly by the State Governments on each of the following commodities, namely:--

- (i) cotton fabrics;
- (ii) woollen fabrics;
- (iii) rayon or artificial silk fabrics;
- (iv) sugar; and
- (v) tobacco including manufactured tobacco.

Provided that the share accruing to each State shall not be less than the revenue realised from the levy of sales tax for the financial year 1956-57 in that State;

- (c) the grant to be made available to the States in lieu of the tax under the repealed Railway Passenger Fares Tax Act, 1957; and
  - (d) the grant to be made available to the States on account of wealth-tax on agricultural property.
7. In making its recommendations on the various matters aforesaid, the Commission shall adopt the population figures of 1971 in all cases where population is regarded as a factor for determination of devolution of taxes and duties and grants-in-aid.
8. The Commission may make an assessment of the non-Plan capital gap of the States on a uniform and comparable basis for the five years ending with 1983-84. In the light of such an assessment, the Commission may under-take a general review of the States' debt position with particular reference to the Central Loans advanced to them and likely to be outstanding as at the end of 1978-79 and suggest appropriate measures to deal with the non-Plan capital gap, having regard inter alia to the overall non-Plan gap of the States, their relative position and the purposes for which the loans have been utilised, and the requirements of the Centre.
9. The Commission may review the policy and arrangements in regard to the financing of relief expenditure by the States affected by natural calamities and suggest such modifications as it considers appropriate, in the existing arrangements, having regard, among other considerations, to the need for avoidance of wasteful expenditure.
10. The Commission shall make its report by the 31st October, 1978 on each of the matters aforesaid and covering a period of five years commencing from the 1st day of April, 1979. The Commission shall indicate the basis on which it has arrived at its findings and make available the State-wise criteria adopted in making modifications, if any, in the States' forecasts of receipts and expenditure".
2. The provisions of the Constitution having a bearing on the constitution and the work of the Finance Commissions have been set out in Annexure I. The Finance Commission (Miscellaneous Provisions) Act, 1951, will be found in Annexure II.
3. Prof. Raj Krishna and Dr. C.H. Hanumantha Rao served as part-time Members throughout the tenure of the Commission. The Chairman and the other Members served on a whole-time basis.

4. The first meeting of the Commission was held in New Delhi on 14th July 1977. The Commission at that meeting adopted rules of procedure similar to those of the earlier Finance Commissions. The Commission also approved of the issue of a Press Note indicating its terms of reference and inviting those interested in its work to furnish written memoranda to the Commission setting out their views and suggestions. A circular letter in similar terms was also addressed to Members of Parliament, Members of State Legislatures, Vice-Chancellors and Heads of Economics Departments of Universities, leading economists and others.

5. Even before the constitution of the Commission, the Department of Economic Affairs in the Ministry of Finance had taken some preparatory steps. In July 1976 all State Governments had been requested to compile information on a number of "Subsidiary Points" bearing on the finances and the economy of the States. Our Member-Secretary was appointed as an Officer on Special Duty in the Ministry of Finance some time before the Commission was constituted. He had addressed the State Governments requesting them to compile forecasts of receipts and expenditure on revenue and capital accounts for the five year period to be covered by our Report (1979-80 to 1983-84). He had also requested some of the Ministries of the Central Government to furnish information likely to assist the Commission. Further, communications were addressed to them as decided by the Commission in its initial meetings. The more important of these communications are set out in Annexure III. The Union Ministry of Finance was also requested to furnish the Commission with forecasts of revenue and expenditure of the Central Government for the five year period of our Report.

6. In September 1977, the Government of India and the Planning Commission decided to terminate the Fifth Five Year Plan with the close of 1977-78 and to initiate a rolling Plan from 1978-79. Since the impact of this decision vis-a-vis our terms of reference was not then quite clear, we addressed the Ministry of Finance and the Planning Commission for a clarification. We were informed by the Ministry that our terms of reference were not affected in any way.

7. At our request, the Comptroller & Auditor General of India was good enough to instruct the Accountants General of the States to assist us by furnishing information which might be needed by us from time to time. We are thankful to them for complying with our requests for information with care and promptitude.

8. Amongst the State Governments the Government of Tamil Nadu was the first to furnish to us forecasts on the revenue and capital accounts. The last State Government to send us its forecasts did so in June 1978. Information on the Subsidiary Points was also considerably delayed by a number of State Governments. The forecasts were examined in our Secretariat, in order to identify points which required clarification and further information from the State Governments. These were communicated to the State Governments before the Member Secretary and other officers of the Commission held detailed discussions with the officers of the State Governments. In this respect we followed the useful practice adopted by the Sixth Commission. The clarifications obtained as a result of these discussions helped us greatly in acquainting ourselves in sufficient depth with the policies and special features of the finances of each State before our discussions with the Chief Ministers and their colleagues.

9. We were able to begin our round of discussions in the State capitals with the Chief Ministers and their colleagues in January 1978. The last of these meetings was held in July 1978. The dates of our visits to the States are set out in Annexure IV. We are glad to say that during these discussions there was a full and frank exchange of views on matters

pertaining to our terms of reference and the special circumstances of the individual States. Our main objective was to get a clear understanding, from the highest levels in the State Governments, of the States' policies bearing upon their finances, as well as of various aspects of their fiscal management. Following the Commission's discussions with the Chief Ministers and their colleagues, our Member Secretary had wherever necessary further meetings with the senior officers of the State Governments in order to go over matters of detail. At these meetings with the State Governments, the Accountant General concerned was, at our request, also generally present and assisted in the discussions. Several State Governments had indicated that the Commission might also visit some areas in order to have a better appreciation of their special problems and of features which, in their view, made for higher costs of services. Some of us were able to make such visits, which turned out to be useful since they gave us a much better feel of the special considerations urged by the State Governments concerned.

10. We would like to record here our gratitude for the ungrudging help and cooperation we received from the State Governments and their officers in all aspects of our work. We would also like to thank the State Governments for the courtesies and hospitality extended to us during our visits to the States.

11. It was gratifying to find during our visits to the State capitals that the Press took keen interest in the work of the Commission. We deeply appreciate such interest. Considering the confidential nature of the discussions we had with the States, we were naturally not in a position to speak freely to the Press wherever they met us. At some places, leading figures from the Press met us to put before us their appreciation of the problems and needs of the State. These meetings were very useful.

12. In response to the Press Note and our letters inviting views and suggestions on our terms of reference, we received a number of memoranda. The Lucknow University organised a seminar especially to discuss some aspects of the Finance Commission's functions, and sent the proceedings to us. A seminar was also held at Hyderabad where a number of leading advocates participated and discussed diverse problems relating to Centre-State financial and other relations. The Commission received copies of the proceedings of the seminar. The National Institute of Public Finance & Policy, New Delhi, organised a seminar, and thereafter forwarded a memorandum to us. We were also able to obtain, through the kindness of Prof. Benjamin Brown of the Harvard Centre of International Affairs, and the Australian National University, as well as through the good offices of some of our Missions abroad, valuable material on federal fiscal relations in other countries. In the course of our visits to the State capitals, as well as at our headquarters in New Delhi, distinguished persons with experience in public affairs, economists, representatives of Chambers of Commerce & Industry, Members of Legislatures and others, who were interested, met us. We took the opportunity of our visit to Bombay to have a very useful discussion with the Governor of the Reserve Bank of India and his colleagues as well as the heads of public sector financing institutions. We would like to express here our appreciation of the trouble and the time taken by them. We have greatly benefited from their statements and from the memoranda we received from them. A list of individuals and organisations, who gave us memoranda, is given in Annexure V, and a list of those who met us in Annexure VI.

13. We have also had detailed discussions with the Secretaries in the Union Ministry of Finance and senior officials of the Ministry, including the Chairman of the Central Board of Direct Taxes and the Central Board of Excise & Customs, and separately with the Home Secretary, the Defence Secretary and the Secretary, Social Welfare. These discussions, concerning the forecast of receipts and expenditure of the Central Government, as well as some other matters pertaining to our terms of reference, were extremely useful.

14. We would like to acknowledge and record our deep appreciation of the ungrudging and painstaking work put in by our officers and research staff. Shri R. K. Dar, Joint Secretary, Shri M. R. Sivaraman and Shri S. K. Das Gupta, Directors, not only provided guidance to the research staff but also did considerable original work on their own. Our Senior Research Officers Sarvashri M. L. Anand, R. D. Gupta, R. N. Jain, J. L. Kapoor and G. G. Nair, and Research Officers Sarvashri P. S. Gill, R. K. Juneja, Manohar Lal, G. P. Sahni and K. Venkataraman, who formed the Research Groups, not only did thorough work in collecting and analysing the voluminous data relating to the forecasts of the States, but also did special studies which were essential for our work in regard to maintenance of capital assets, returns on investments in power, irrigation and public undertakings, and the proposals of the States for upgrading the standards of administration. The thoroughness with which they all worked was such that we rarely had occasion to ask the Secretariat for further information or clarification after a paper on a subject had been prepared and brought up before the Commission. Shri P. B. Dhawan, in view of his experience in the work of the Finance Commission, was not only of great help to the Chairman as his Private Secretary, but also handled the forecast of one of the major States. Similarly, Shri K. B. L. Mathur, Private Secretary to Prof. Raj Krishna, gave valuable assistance to the senior officers of the Commission with his specialised knowledge of analytical work in the economic field. We should also acknowledge here the quiet and smooth efficiency with which our house-keeping staff worked for us, guided by Shri P. L. Sakarwal, Under Secretary, Shri H. R. Meraney, Superintendent and Shri P. N. Sachdev, Accounts Officer. Each of us would also like to add that our personal staff performed their duties to our entire satisfaction.