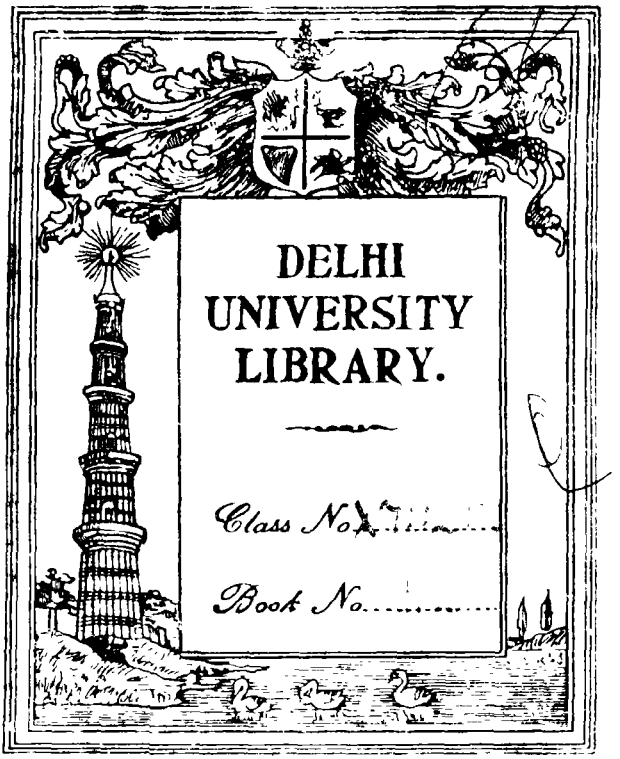

DELHI
UNIVERSITY
LIBRARY.

Class No.....

Book No.....

Cl. No. X7::2:N3 H2

Date of release for loan

Ac. No. 38216

This book should be returned on or before the date stamped last below. An overdue charge of one anna will be charged for each day the book is kept overtime.

TO

SIR SARVEPALLI RADHAKRISHNAN

VICE-CHANCELLOR

BENARES HINDU UNIVERSITY

INDIAN PROVINCIAL FINANCE, 1919–39

WITH SPECIAL REFERENCE TO THE UNITED PROVINCES AND WITH AN ADDITIONAL CHAPTER ON PROVINCIAL FINANCE UNDER THE 1935 CONSTITUTION

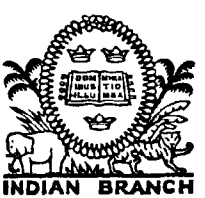
BY

B. R. MISRA, M.A., Ph.D. (London), LL.B.

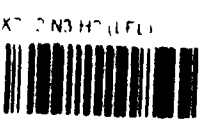
Professor of Economics and Head of the Departments of Economics and Commerce, Benares Hindu University

WITH A FOREWORD BY

VERA ANSTEY, D.Sc. (Econ.)



HUMPHREY MILFORD
OXFORD UNIVERSITY PRESS



OXFORD UNIVERSITY PRESS
AMEN HOUSE, LONDON, E.C. 4
Edinburgh Glasgow New York
Toronto Melbourne Capetown
Bombay Calcutta Madras
HUMPHREY MILFORD
PUBLISHER TO THE
UNIVERSITY

Thesis approved for the Degree of Doctor of Philosophy in the Faculty of Economics, University of London

First Published, January 1942

PRINTED IN INDIA
AT THE WESLEY PRESS AND PUBLISHING HOUSE
MYSORE CITY

FOREWORD

Dr Misra's study of the development and problems of provincial finance in India is of great topical as well as of permanent academic interest. War conditions necessarily increase the importance and difficulty of raising and expending public monies, and although India is far from the seat of war, there are special reasons why the present moment is critical, in every sense of the word, for India's financial future. The outbreak of war found India on the eve of the erection of the coping-stone to the constitutional edifice which has been so long in course of construction, i.e. of the All-India Federation. Some may conclude that the halt to constitutional development necessitated by war preoccupations will simply postpone consideration of the financial problems involved, and result in a stagnant period, during which the construction of a long-term financial programme will be replaced by ephemeral schemes designed to make temporary provision for urgent war-time needs. But this attitude would be superficial and most unfortunate. It may be true that this is not the moment to suggest far-reaching changes in the general structure of the Indian financial system, but it most certainly is the moment to examine meticulously the existing structure, to make sure its foundations are well and truly laid, and to reconsider the lines along which progress can best be attained when it once again becomes possible to take up the task of constitutional reform. If the opportunity is lost, irreparable damage may be done.

Public administration, of which public finance is the very core, necessarily takes a pyramidal form. The base consists of local administration—entrusted to local authorities, such as the parish (in England) or the *panchayat* (in India)—upon which rests district administration, which in its turn supports (in India) provincial administration, and finally federal administration. The strength of the whole structure depends largely upon the soundness of its foundations. Hence the progressive realization of responsible self-government, and of Dominion

Status, depends ultimately upon the development of local self-government, and upon the proper administrative (including financial) co-ordination of the functions and powers of the whole series of authorities. But it is precisely in these spheres that there has, in India, been great weakness in the past. Local administration and finance are still in an embryonic stage, and until progress is made in this respect it is difficult to see how the provincial and federal financial systems can be reorganized and expanded along really satisfactory lines. The present 'halt' in constitutional development—however much it may be deplored on other grounds—could undoubtedly be utilized to great advantage for a thorough reconsideration of the principles which should permeate Indian public finance as a whole, and for the development and full utilization of the powers of local authorities. The reform and development of the finances and functions of the minor authorities form, indeed, a necessary preliminary to the creation of a sound and progressive future financial programme for India as a whole.

Dr Misra's study of provincial finance, which includes within its purview both local finance, the financial relations between the Provinces and the central authority, and the need for greater co-ordination, throws much light upon the weak spots in the existing system and on the principles which should guide financial reform. These principles are analyzed in relation to welfare in the broadest sense of the term, and not merely in relation to formal financial considerations. Above all it can be said that Dr Misra has depicted the complicated story of the development of the present financial system and has analyzed the outstanding relevant problems not in order to promote the programme of a particular party or group of interests, but from a broad and detached—i.e. a truly independent and scientific—point of view.

My pleasure in introducing this work to the public is enhanced by the fact that it was my duty to act as Dr Misra's supervisor during his recent two years' residence in London. Throughout that period I was much impressed by his untiring pursuit of knowledge, his deep desire to consider all aspects of his chosen theme, and his independence of thought. His re-

commendations will, no doubt, provoke criticism and controversy, but it can at least be said that they represent the honest conclusions and judgements of a well-informed student of India's economic and financial problems.

VERA ANSTEY

LONDON SCHOOL OF ECONOMICS
November 24, 1939

PREFACE

Provincial finance has so far been studied mainly from the point of view of the allocation of resources between the Central Government of India and the Provincial Governments. Little or no attempt has been made so far either to analyse the provincial tax structure or to examine the effects of the provincial expenditure on the life of the people. I have attempted in this study to fill this gap.

With this object, a brief historical survey together with a detailed account of the Montagu-Chelmsford Reforms and the Meston Settlement is given at the outset. This has been followed by an examination of the main heads of revenue and expenditure and their effects on the life of the people. Next, the various problems of local taxation are examined and the need for co-ordinating the tax policy of the Provincial Governments and Local Authorities is pointed out. Lastly, suggestions are made regarding the future policy of the Provincial Governments.

The work originally undertaken was to examine the financial arrangements of the Reforms period, 1919–37. I have, however, added an additional chapter on Provincial Autonomy pointing out the constitutional and financial relationship between the Government of India and the Provincial Governments under the Government of India Act, 1935. It is difficult to pass judgement on the working of Provincial Autonomy as the period of its working has been not only too brief but has also been interrupted by the resignation of Congress Ministries in several Provinces.

Finally, I have come to the conclusion that the task of a Government in India, whether 'alien' or 'Indian', in face of the vastness of the area, the phenomenal increase in population, the uneconomic outlook of the people, and too much reliance on Government, is particularly difficult. Hence, together with change in the financial policy the removal of some of the fundamental obstacles in the way of the 'arrested' economic development of India is advocated.

It is thus, it is suggested, that provincial finance may be utilized as a means for the improvement of the condition of the masses in India.

In the preparation of this work, I have received invaluable help from Dr Vera Anstey of the London School of Economics. Without her guidance the work would never have seen the light of day. It is impossible for me to express adequately my deep sense of gratitude to her. Dr Frederic Benham, Sir Ernest Cassel Reader in Commerce in the University of London, corrected several chapters of the work and offered useful critical comments at every stage of the investigation. I am grateful to him for the help.

I am also obliged to the Librarians of the London School of Economics, the High Commissioner for India, and the India Office, for the abundant facilities which they always placed at my disposal.

Dr Vera Anstey has kindly written the Foreword to the work. For this kindness, my special thanks are due to her.

I am beholden to Sir S. Radhakrishnan, Vice-Chancellor, Benares Hindu University, for allowing me the privilege of dedicating the work to him.

Finally, I must express my thankfulness to my publishers, the Oxford University Press, for the care they have bestowed on the preparation of the MSS. for the press.

B. R. MISRA

BENARES HINDU UNIVERSITY
July 31, 1941

CONTENTS

PAGE

I. INTRODUCTORY 1

§1. POVERTY AMIDST PLENTY—Causes of arrested economic development—Object of this study—Diversity of economic conditions—The provinces of British India—Areas and population—Occupational distribution of the people—The monsoon and the budget—The promotion of irrigation—The size of the holdings—The geographical distribution of industries—Conclusions.

§2. CONDITIONS OF FINANCIAL REFORM—(i) *Possibility of augmenting government revenues*—Lines of financial reform—Scope for retrenchment—A change in attitude towards taxation—Taxation is a matter of compromise—(ii) *Principles underlying the allocation of resources between the federation and federating authorities*—Allocation of functions—Distribution of resources, principles of efficiency and suitability—The principle of adequacy—The principle of transferences—Allocation between different services—(iii) *The allocation of resources between the central government and the provinces*—Allocation a matter of compromise—Allocation of the principal sources of revenue—Balancing factors.

§3. LOCAL FINANCE—Need for co-ordination—Onerous and beneficial services—Principles of local finance—Plan of the work.

II. HISTORY OF PROVINCIAL FINANCE (1833–1919) 37

§1. CENTRALIZED SYSTEM OF FINANCE (1833-71)—The Charter Act of 1833—Defects of the system—India Councils Act (1861)—A period of deficits.

§2. FINANCIAL LANDMARKS IN THE LATER NINETEENTH AND EARLY TWENTIETH CENTURIES—Lord Mayo's Reforms (1870)—Advantages of the scheme—Defects of the scheme—Lord Lytton's Reforms (1877)—Settlements of 1882—Defects of Quinquennial Settlements—Quasi-permanent Settlement (1904)—The advantages of the Quasi-permanent Settlements—Permanent Settlements (1912)—Defects of the Permanent Settlements—Conclusions.

III. THE MONTAGU-CHELMSFORD REFORMS ... 58

§1. THE CONSTITUTIONAL BASIS—The introduction of limited responsible government—'Central' and 'provincial' subjects, 'reserved' and 'transferred' subjects—The administration of transferred and reserved subjects—The principle of joint responsibility—Local self-government.

§2. THE CHANGES IN THE FINANCIAL SYSTEM—Abolition of divided heads—'Imperial' and 'provincial' sources of revenue—Difficulties in equitable provincial financial settlements—Provincial contributions—Criticism of the basis of the provincial contributions—The Meston Committee—The Meston Award—Initial contributions—Standard contributions—Changes made by the Devolution Rules—Provincial loan account—Irrigation under the Reforms—Provincial borrowings—'Scheduled taxes'—Provincial budgets—Conclusion.

IV. THE MESTON SETTLEMENT AND ITS RESULTS 82

§1. THE WORKING OF DYARCHY—The administration of reserved and transferred subjects—Joint or separate purse—The defects of dyarchy.

§2. THE EARLY FINANCIAL DIFFICULTIES IN THE WORKING OF THE MESTON SETTLEMENT—The unforeseen economic circumstances—Heavy central and provincial deficits—The difficulties in the early abolition of provincial contributions—Conclusion—Provincial contributions (1921–7).

§3. THE MESTON SETTLEMENT EXAMINED—The division of functions between the central and provincial governments—The provincial sources of revenue were inelastic—The central sources of revenue were elastic—The necessity for provincial contributions—The so-called injustice of the Meston Settlement examined—Defects of the Meston system—Conclusion.

V. PROVINCIAL AUTONOMY 107

§1. CONSTITUTIONAL BASIS—Provincial autonomy a natural development—Distribution of legislative powers—Essence of provincial autonomy—Main features of provincial autonomy.

§2. THE CHANGES IN THE FINANCIAL SYSTEM—Introductory —Allocation of sources of revenue between the federation and the federal units—Distribution of income-tax and corporation tax—The distribution proposed—The report of the Second Peel Committee—White Paper proposals—Joint Committee report—Sir Otto Niemeyer's report—Deficit provinces—Export duty on jute—Summary of various forms of assistance—Review of the report—Conclusion.

VI. THE FINANCIAL SYSTEM AND ADMINISTRATION 132

§1. THE FINANCIAL SYSTEM UNDER THE REFORMS, 1919—Scope of the chapter—Functions of the Finance Department—Position of the Finance Department—Criticism of the Finance Department—Working of the joint budget—Voted and non-voted items—Standing Finance Committee—Public Accounts Committee.

§2. PROVINCIAL AUTONOMY, 1937—Financial procedure—Non-votable heads of expenditure—System of demands for grants—Conclusions.

VII. LAND REVENUE 144

§1. INTRODUCTORY.

§2. REVISION OF LAND POLICY—(i) *Defects of land revenue*—A tax *in rem*—An element of progression should be introduced—Advantages of the scheme—Should an uneconomic holding be exempted from the payment of land revenue or rent?—(ii) *Abuse of tenant law*—Illegal exactions—(iii) *Provincial inequalities caused by permanent settlement*—(iv) *Taxation of agricultural incomes.*

§3. CONCLUSIONS.

VIII. IRRIGATION, FORESTS AND EXCISE 164

§1. IRRIGATION—Irrigation under the reforms—Revenue from irrigation—Nature of irrigation finance—The basis for water charges—Conclusion.

§2. FORESTS—Area under forests—State control—Theory of forest finance—Indian forest policy—Forest revenue and expenditure—Conclusion.

§ 3. EXCISE—Introductory—Lessons from American experience—Excise policy of the Provincial Governments—Revenue from excise—Hemp drugs—The Congress prohibition programme—Conclusion.

IX. MISCELLANEOUS TAXES 193

§ 1. STAMPS, REGISTRATION AND COURT FEES—Theory of taxes on transfers of property—Objections to stamp duties—Income from stamps and registration—Principal guides to stamp rates and registration fees—Court fees.

§ 2. DEATH DUTIES—The equity of death duties—Objections to death duties—Types of death duties—Probate duties in India—The rates of probate duties and their yield—The law on probate duties—Mitakshara and Dayabhaga law—Results of the differences in laws—The best method to make all succession liable to taxation.

§ 3. SCHEDULED TAXES—Taxation of Entertainments—General considerations—Taxation of betting—Betting tax in India.

§ 4. CONCLUSIONS—The burden and incidence of taxation—Regressive nature of the tax system.

X. PROVINCIAL EXPENDITURE 222

§ 1. EXPENDITURE ON LAW AND ORDER—Introductory—Expenditure on law and order.

§ 2. EXPENDITURE ON DEVELOPMENT DEPARTMENTS—(i) *Education*—Primary education—Secondary education—University education—Summary and conclusion—(ii) *Medical and Public Health*—Review of public health services—Public health and epidemics—Public health and local authorities—Medical department—Medical aid and local authorities—Lack of voluntary help—Medical relief for women—Summary and conclusion—(iii) *Agriculture*—Difficulties in agricultural improvement—Land revenue not the cause of poverty—Agriculture and state policy—Agricultural marketing—Conclusions—(iv) *Industries*—Need for a better-balanced economic system—Famine relief fund.

§ 3. CONCLUSIONS.

XI. THE PROVINCIAL BUDGETS 253

§ 1. BUDGETARY POLICY (1921-39)—Introductory—Initial financial difficulties—Review of revenue and expenditure (1921-39).

§ 2. STAGNATION OF REVENUE—Progress of revenue under principal heads—Conclusions.

XII. LOCAL TAXATION 271

§ 1. INTRODUCTORY.

§ 2. THE PROBLEM OF AREAS AND FUNCTIONS—Causes of decay of village communities—The area served by the district boards is too large—Optimum size of local bodies—A plea for the revival of village *panchayats*—Re-allocation of functions between district boards and village *panchayats*.

§ 3. MAIN SOURCES OF INCOME OF LOCAL AUTHORITIES—Income of municipalities — Income of district boards — (1) Taxes on trade—(2) Taxes on property—(3) Taxes on persons—(4) Fees and licenses—Conclusions.

§ 4. FINANCIAL CO-ORDINATION BETWEEN THE LOCAL AUTHORITIES AND PROVINCIAL GOVERNMENTS—Need for grants-in-aid—Advantages of grants-in-aid—Grants-in-aid: their need in India—Principles of grants-in-aid: percentage grants and block grants—Summary—Local indebtedness: Conditions under which local authorities should borrow—Conclusions.

XIII. SUMMARY AND CONCLUSIONS 295

§ 1. RECENT TENDENCIES IN PROVINCIAL FINANCE AND POLICY.

§ 2. THE PRESENT OUTLOOK—The fundamental obstacles to the development of social services.

§ 3. POSSIBLE LINES OF PROGRESS.

APPENDIX I 303

SOME PRINCIPLES OF TAXATION.

APPENDIX II 329
LEGISLATIVE LISTS.

BIBLIOGRAPHY 339

INDEX 343

INTRODUCTORY

§1. *POVERTY AMIDST PLENTY*

Causes of Arrested Economic Development

The most arresting fact about India is that her soil is rich and her people poor.[1] Here is a country with rich natural resources but the poverty of its people is a byword throughout the world. This paradox of Indian economic life is principally due to over-population, the uneconomic outlook of the people, and the absence of a more equitable tax system. The discussion of the first two topics lies outside the scope of this work. Nevertheless, a passing reference to them is essential.[2]

Here people breed like rabbits and flies; malaria, hook-worm and plague drain the prosperity of the country. The pressure of population on the land has considerably increased with the result that in many tracts of India the majority of the holdings are below the economic size. In the absence of proper manuring facilities and rotation of crops the practice of a highly intensive cultivation has turned agriculture into robbery of the soil.[3] The general prosperity of India can never be substantially increased so long as an increase in income is absorbed by an increase in population. 'The population problem lies at the root of the whole question of India's economic future, and it is useless to try to bilk the fact.'[4]

[1] DARLING, M. L., *The Punjab Peasant in Prosperity and Debt* (Oxford University Press) 1932, p. 67.

[2] The most convincing account of these topics is given in DR ANSTEY'S *The Economic Development of India*. See especially ch. xviii, p. 399.

[3] See ch. x.

[4] ANSTEY, V., *The Economic Development of India* (Longmans) 3rd edition, 1936, p. 475. The references throughout this work are to this edition.

The population of India between 1921–31 increased from 318·9 millions to 352·9 millions. The increase in British India was 10·0 per cent and in Indian States 12·8 per cent. The increase in population within the last 50 years has been 88·6 millions, i.e. 34·9 per cent.

For the solution of the problem we can exclaim with Dr Anstey: Where is the Indian Malthus who will inveigh against the devastating torrent of Indian children?[1]

The present uneconomic outlook of the people is another fundamental obstacle to the economic progress of India. The life of an average citizen is still governed by custom, tradition, superstition and ignorance. The working of economic laws in India is dependent, to some extent, upon the cultivator's belief in the doctrine of an inexorable fate. Even with regard to agricultural improvements which would considerably improve his economic position, his unwillingness, sometimes, to adopt them is due to the absence of this outlook. The cultivator still lacks that mental equipment which will go to make his business more remunerative.

Not only is the absence of the economic outlook noticeable in cultivators, it is remarkably prominent amongst the landed aristocracy. The latter has failed to realize and utilize the vast potentialities of agriculture. Landlords have been satisfied with receiving income from land without performing any extensive economic and social functions.[2] If the Indian landlord had invested to a greater extent in agricultural development and had taken advantage of existing knowledge, the present-day economic problems in India would have been entirely different from what they are now. The weak economic motive and lack of economic enterprise is essentially responsible for turning agriculture into a depressed industry.

No amount of reform will increase the prosperity of cultivators unless it is realized that a static social ideal cannot co-exist with a progressive economic ideal.[3]

Finally, the financial problem has undoubtedly been an important factor in the arrested economic development of India.[4] The reason is not far to seek. On the one hand, a constructive social and economic policy followed by the Government is everywhere creating greater demands upon the public purse; on the other hand the inadequate fiscal basis and the fiscal machinery in raising the revenue from a

[1] See ch. xiii. [2] See chs. x and xiii. [3] ANSTEY, op. cit., p. 476.
[4] ibid., p. 399.

population mainly consisting of poverty-stricken cultivators, without either oppressing the masses or offending the political classes, is getting out of gear.[1] Thus the pressure is felt at both ends. To maintain the type of administration introduced by the Government, expenditures are fast growing and the old forms of revenue are proving oppressive, inadequate or unsuitable.[2] Hence discontent with the financial policy of the Government is growing apace. And since the expenditure of the Provincial Governments and local authorities affects more intimately the life of an average citizen than that of the Central Government, the problems of provincial and local revenues are becoming increasingly difficult and important.[3]

Object of this Study

To what extent, and why, are the Provinces suffering from financial stringency?[4] What have been the nature, extent and results of the changes brought about by the Reforms of 1919 and provincial autonomy (1937) on the provincial financial system?[5] Can any improvement be traced in the administration of the services commonly styled nation-building?[6] What are the main obstacles to the development of the financial resources of the Provinces?[7] What are the possible remedies for defects?[8]

Answers to these and many closely allied questions will be attempted in the following pages.

Diversity of Economic Conditions

One further question needs our attention. In a continent like India, covering an area of no less than 1·8 million acres and with a population of 352·8 millions (1931), the financial problems will naturally assume a somewhat different form in various Provinces. The transition from the North-West Frontier Province, the arid zone of Rajputana and the highly fertile areas of Bengal to the complex industrial life of Bombay, presents striking differences in economic conditions. There are thus almost insuperable difficulties in attempting to solve as a

[1] ANSTEY, op. cit., p. 365. [2] See chs. x and xi. [3] See chs. xii and xiii.
[4] See chs. xi and xiii. [5] See chs. iii, iv and v. [6] See ch. x.
[7] See ch. xiii. [8] See ch. xiii.

whole the financial and economic problems of such a vast and varied area as India. What is good for Bombay is not necessarily good for the Punjab, or the newly constituted Province of Sind.[1] Nevertheless, with the introduction of British rule a number of strong unifying forces are at work which make certain phenomena common to all. The land revenue and rent problems, though different in type and degree, are found throughout the country. The tariff of the country affects little villages as well as important commercial centres. With better development of the means of transportation more homogeneous economic conditions will arise in the future and it is reasonable to suppose that India is becoming an economic unit.[2]

Recently, however, it has been suggested that with provincial autonomy this progress may receive some check. There is a danger (?) of provincial economic nationalism, e.g. Madras and other Provinces may no longer be content to get their cotton goods and sugar largely from the north, and will tend to establish their own factories. This may lead to depression in certain districts and industries, and may alter the distribution of incomes and hence the financial problem of certain Provinces.

The Provinces of British India

It would be desirable, before entering upon any financial description or discussion, to give a brief account of the main features of the economic life of the Provinces into which British India is divided. The description of the economic conditions, Province by Province, would involve repetition. Hence a view of British India as a whole may be of advantage.

British India is now[3] made up of eleven Governors' Provinces, viz. Madras, Bombay, Bengal, the United Provinces, the Punjab, Bihar, the Central Provinces and Berar, Assam, the North-West Frontier Province, Orissa and Sind.[4] The Chief

[1] See chs. iii and iv. [2] See ch. xiii. [3] 1937.

[4] Under the Act of 1919, there were only nine Governors' Provinces. The two new Provinces of Orissa and Sind have been created since 1937. Burma was made a Governors' Province in 1923. Since 1937 it has been separated from British India. The North-West Frontier Province has been raised to a Governors' Province since 1937. The account in this work applies to the nine Governors' Provinces under the Act of 1919.

Commissioners' Provinces are British Baluchistan, Delhi, Ajmer-Merwara, and Coorg, the Andaman and Nicobar Islands and Panth Piploda. It may be stated here that the following pages refer in the main to the United Provinces; the conclusions reached, however, apply to a limited extent to the other Provinces.

Areas and Population

The total area covered by India amounts to about 18,00,000 square miles—that is to say, more than twenty times the area of Great Britain. To employ another method of comparison, India and Burma together are as large as the whole of Europe excluding Russia. Of the total area of India 7,09,583 square miles lies within the boundaries of the Indian States.

It may be interesting to mention that Burma is greater in area than the whole of France; Madras and Bombay (including Sind) are each bigger than Italy; the Punjab, the United Provinces and the Central Provinces each exceed Great Britain in area; Bihar and Orissa (combined) are close in size to Great Britain; Bengal is slightly smaller than Great Britain; and Assam, which is the smallest Province under the Reforms, is equal in size to England.

An analysis of the population figures is no less striking than that of areas. The total population of India, according to the census of 1931, was 352·8 millions. Of these, 271·5 millions were enumerated in British India, and 81·3 millions in the Indian States. Thus, at the present day India contains about one-sixth of the population of the whole world. The area, population, and density of the larger Provinces and some important European countries are shown in Table I.

TABLE I

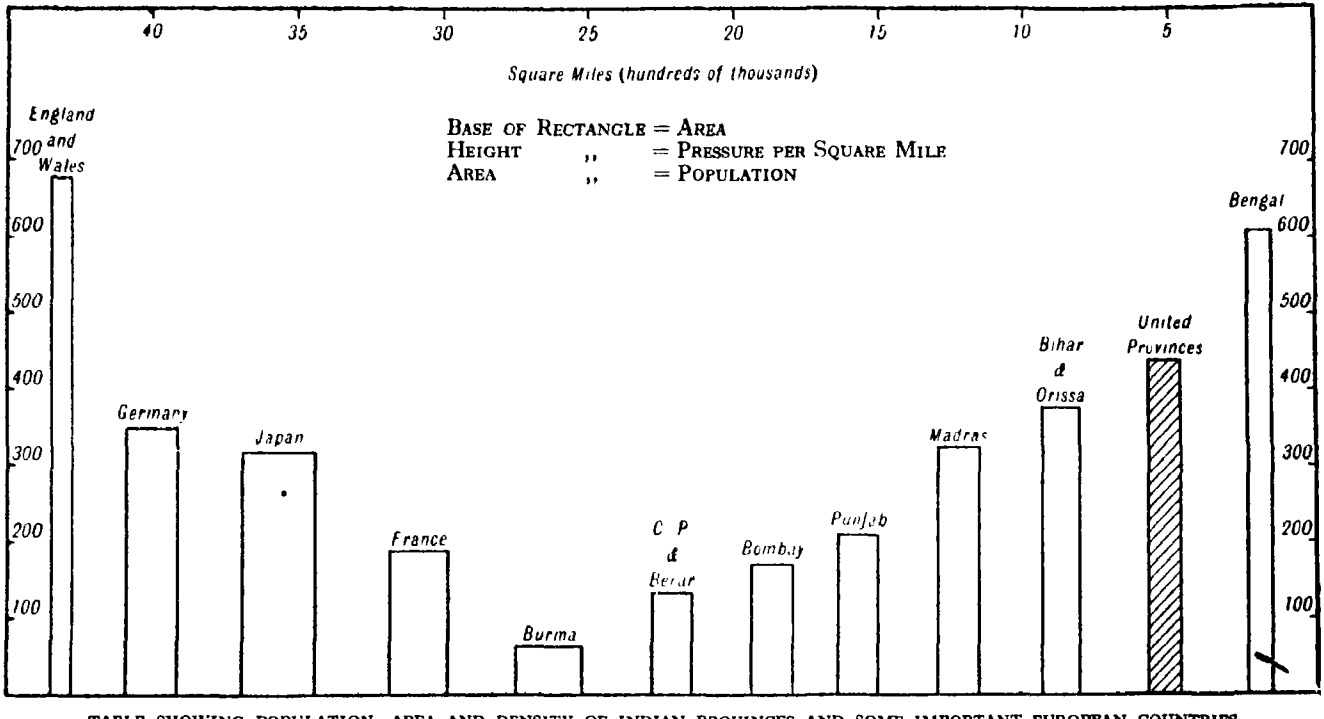


TABLE SHOWING POPULATION, AREA AND DENSITY OF INDIAN PROVINCES AND SOME IMPORTANT EUROPEAN COUNTRIES

TABLE II

PROVINCE OR STATE	AREA IN SQUARE MILES	ORDER IN POINT OF AREA	POPULATION	ORDER IN POINT OF POPULATION	PERSONS PER SQUARE MILE	ORDER IN POINT OF DENSITY
India	1,808,666	...	352,837,778	...	195	...
Assam	67,334	13	9,247,857	11	137	9
Baluchistan	134,638	5	868,617	14	6	15
Bengal	82,995	11	51,087,338	1	616	2
Bihar and Orissa *	111,784	9	42,329,583	4	379	4
Bombay	151,593	2	26,271,784	6	173	8
Burma	233,492	1	14,667,146	8	63	13
Central Provinces and Berar	131,095	6	17,990,937	7	137	9
Delhi	573	15	636,246	15	1,110	1
Hyderabad	82,698	12	14,436,148	9	175	7
Kashmir and Jammu ...	84,516	10	3,646,243	13	43	14
Madras	143,870	3	47,193,602	3	328	5
North-West Frontier Province	46,356	14	4,684,364	12	129	11
Punjab	135,496	4	28,490,857	5	210	6
Rajputana	129,059	7	11,225,712	10	87	12
United Provinces	112,191	8	49,614,833	2	442	3

ource: *Census Report of the United Provinces* (1931) Part I. Report, p. 7.

The area, population and density of Sind and Orissa (the two new Governors' Provinces) is given below:

Sind [1] Area, 46,378 sq. miles. Population, 3,887,070. Density, 84.
Orissa [2] ,, 33,000 ,, ,, 8,277,000.

[1] See Census of India (1931) Vol. I. Part I, pp. 15, 16. [2] The present area and population of Orissa, however, does not correspond exactly to the area and population of 1931 because some areas in Madras and the Central Provinces occupied by Oriya people are included in it. See *Orissa Committee Report* (1932), Vol. I, p. 34.

Table I shows that Bengal, the United Provinces, Madras and Bihar and Orissa (combined) have, each of them, more population than England and Wales. The population of the United Provinces is greater than that of Italy or France. The population of Oudh alone is one and a quarter times that of Canada, and the population of the Gorakhpur and Fyzabad divisions each exceeds that of Australia.[1]

From Table II several important conclusions follow which must profoundly affect the financial system and policy of the Government. In India where the average density in extensive rural areas exceeds that of almost any other part of the world extreme poverty must prevail. The assertion that India is not over-populated, in face of a smaller produce per head in spite of the great increase in total production during the present century, cannot be supported. Under present conditions there is good reason to suppose that in many areas the 'optimum' population has long since been surpassed.[2] The excessive pressure of the population must result in a miserably low standard of life for the masses. This must inevitably react on the finances of the Government and make its task more difficult.

Secondly, the unequal distribution of population (combined with physical facts and natural resources) accounts for the conclusion 'that the standard of service rendered by Provincial Governments—both in quality and in amount—is appreciably lower in the poorer parts of India than in those that are more well-to-do'.[3] The above assertion of the Statutory Commission is supported by the disparities between the total expenditure per head in various Provinces. This is shown in the table on the next page.

[1] See *United Provinces Census Report* (1931), vol. xviii, p. 8.

[2] ANSTEY, op. cit., p. 4.

[3] See *Report of the Indian Statutory Commission*, Cmd. 3569 (1930), p. 232.

Province	Average annual provincial expenditure 1933–6 (in thousands of rupees)	Population 1931	Expenditure per head of population
			Rs.
Madras ...	15,59,66	47,193,602	3·3
Bombay ...	14,64,97	26,271,784	5·6
Bengal ...	11,13,61	51,087,338	2·2
United Provinces	11,46,79	49,614,833	2·3
Burma ...	9,22,94	14,667,146	6·3
Central Provinces	4,66,98	17,990,937	2·6
Assam ...	2,56,01	9,247,857	2·8
Punjab ...	10,23,44	28,490,857	3·6
Bihar and Orissa ...	5,29,88	42,329,583	1·3

Third, the unequal distribution of population creates difficulties in the allocation of resources. Indeed, the vast differences in areas and population make it very difficult to set up any standard for the allocation of resources which may be acceptable to all the Provinces. The authors of the Indian Statutory Commission rightly observed that 'it costs more to run a Province with a scattered population than one which is densely populated; the cost of roads and medical and sanitary services must be higher per head'.[1] Hence in any attempt to establish an objective standard of fairness between the Provinces in the distribution of resources the factors of population and areas should be taken into consideration.[2]

Occupational Distribution of the People

At the census of 1931 the occupational distribution of the Indian population was briefly as follows:[3]

Occupation	Percentage of the total population
1. Exploitation of Animals and Vegetation	67·0
2. Exploitation of Minerals	0·1
3. Industry	9·7
4. Transport	1·5
5. Trade	5·4

[1] Cmd. 3569 (1930), p. 232.

[2] See chs. ii, iii and iv.

[3] See *Census of India* (1931), Part I, Report, p. 276.

Occupation	Percentage of the total population
6. Public Force	0·5
7. Public Administration	0·8
8. Professions and Liberal Arts	1·7
9. Miscellaneous (persons living on their income, domestic service, insufficiently described and unproductive occupations)	13·3

The figures establish the predominance of agricultural and pastoral pursuits over all other occupations. The predominantly rural character of the population and the dependence of the vast majority of the people upon agriculture have profoundly affected the budgetary calculations and nature of Indian financial problems. The prominent place which the land revenue has always occupied in the fiscal system of India will be treated in a special chapter below.[1] At this point we will examine shortly the connexion between the dependence of agriculture on the vagaries of an uncertain monsoon rainfall and the consequent policy and functions of the Government in this respect.

The Monsoon and the Budget

The nature of the monsoon is probably the most important cause of prosperity or distress in India.[2] The failure of the rains caused widespread famines during the last century and devastated huge areas of the countryside. During the nineteenth century much energy and money were spent in the handling of the problem of drought and in the organization of famine relief. During recent times the worst effects of the failure of the monsoon rainfall have been guarded against by the construction of huge irrigation works and the improvement of the means of communication and transportation, especially by the construction of railways. 'Indeed, the famine codes published in the early years of this century are mostly obsolete and lie undusted on the office shelves.'[3] Nevertheless, even today, as more than four-fifths of the cultivated area is still dependent upon rainfall, the monsoon months

[1] See ch. vii.

[2] ANSTEY, op. cit., p. 157.

[3] BLUNT, SIR EDWARD (edited by), *Social Services in India* (H.M.S.O.) 1939, p. 112.

are a subject of deep concern to the masses in general and to the cultivator and the Government in particular.

A former Finance Member of the Government of India called the Indian estimates a 'gamble in rain'. Although modern financial conditions have much improved, still the monsoon continues to be the most important disturbing factor in the budgets of the Provincial Governments. An unfavourable monsoon means expenditure on famine relief, and suspensions and remissions of land revenue by the Provincial Governments.[1] The finances of the Central Government are affected indirectly. Failure of rainfall reduces the purchasing power of the masses, which tends to diminish the volume of the external and internal trade of the country. This reduces the receipts from customs, income-tax and railways which are the principal sources of revenue of the Central Government. In brief, loss of revenue and increase of expenditure combine to dislocate the finances of the Government.

The Promotion of Irrigation

The overwhelming importance of agriculture and the desire to place agriculture on a sounder basis free from the fluctuations of the monsoon rain led the Government to construct irrigation works. In a later chapter we examine the nature of irrigation finance.[2] Here we briefly state the part which irrigation plays in the rural economy of the Provinces. Irrigation is of chief importance in Sind, the Punjab, the North-West Frontier Province, the United Provinces, Bihar and Madras. A comparison of the irrigated areas during 1935–6 by means of Government irrigation systems with the total area sown in the several Provinces is given below:[3]

[1] See ch. xi.

[2] See ch. viii.

[3] Recently, with the development of hydro-electric power in the western districts of the United Provinces, the Government is building tube-wells on a large scale at its own expense and selling water to cultivators at rates which compare favourably with canal rates. There will be 1,490 Government tube-wells scattered over seven districts by the end of 1938–9. About 300 of these have been constructed by landlords. See BLUNT, op. cit., p. 16.

Provinces[1]	Areas in thousands of acres		Percentage of cultivated area that is irrigated	Estimated value of crops raised (in lakhs of rupees)
	Cultivated	Irrigated		
Punjab	31,850	11,195	35·15	3,900
Sind	4,808	4,316	89·26	776
North-West Frontier Province ...	2,242	431	19·22	150
United Provinces ...	35,278	4,319	12·2	2,210
Bihar and Orissa ...	28,075	940	3·3	368
Madras	36,628	7,552	20·60	2,232
Bombay	26,375	372	1·41	192

Judged from a purely financial point of view the returns realized by irrigation and navigation works have shown profits. The total capital outlay, direct and indirect, on irrigation and navigation works (including works under construction) amounted at the end of the year 1935–6 to Rs. 15,318 lakhs. The gross revenue for the year was Rs. 1,378 lakhs and the working expenses Rs. 502 lakhs; the net return on the capital being 5·7 per cent. The return on capital invested in 'productive' irrigation works was highest in the Punjab where the canals yielded 14·2 per cent. The return was 8·4 per cent in the North-West Frontier Province, 7·4 per cent in Madras, 6·7 per cent in Bihar and Orissa, 6·3 per cent in the United Provinces and 5·1 per cent in Burma.[2]

Perhaps no sphere of Governmental activity during the last half-century has benefited the cultivators more than irrigation; it helps the farmer to avoid debt; it enables him to keep himself busy all the year round; it has increased national prosperity and ensured the State's revenues. There can be no doubt that the influence of irrigation is deeply rooted in the system of provincial finance. Its importance, however, varies in different Provinces.[3]

[1] *Triennial Review of Irrigation in India*, 1933–6. Issued 1938, p. 4.

[2] See *Triennial Review of Irrigation in India*, 1933–6, p. 3.

[3] See ch. viii.

The Size of the Holdings

The growth of the population and overwhelming predominance of agriculture have resulted in the prevalence of small holdings in the case of the great majority of Indian cultivators. Intensive village surveys reveal that in most parts of India the majority of the holdings are below the economic size. In an intensive village survey which I conducted in a Cawnpore village, I found the distribution of land in the village to be as follows:[1]

Tenants cultivating	1 acre	numbered 100
do	2 acres ...	50
do	between 3 and 4 acres ...	42
do	between 5 and 6 acres ...	19
do	about 10 acres	14
do	about 15 acres	2
do	over 15 acres	nil

The average size of the holding for the village was 2·47 acres. Holdings vary greatly in size in different parts of the Province, the average being as high as 12 acres in precarious regions of Bundelkhand, and as low as 3½ acres in fertile areas of the eastern districts.[2]

Similar statistics are available for other Provinces. In an inquiry conducted in some 2,400 Punjab villages for the Royal Commission on Agriculture it was found that 22·5 per cent of cultivators cultivated 1 acre or less; 33·3 per cent cultivated between 5 and 10 acres; and 23·7 per cent cultivated 10 acres or more.

The prevalence of small holdings raises important questions in the field of public finance in India. How many of the holdings are economic holdings? How far can the land revenue policy pursued by the Government be held responsible for the present poverty of cultivators? Can the uneconomic holding be exempted from land revenue or rentals? Will a low assessment and low rentals solve the problem of the poverty of the peasantry?

[1] MISRA, B. R., *An Economic Survey of a Cawnpore Village* (Government Press, Allahabad) 1931, p. 15.

[2] *Report of the United Provinces Banking Enquiry Committee*, 1929–30, vol. i, p. 22.

What are the main obstacles to adjusting land revenue or rents to the size of the holdings? What can be done to improve the situation? Answers to these and to many closely allied questions will be sought in the chapter or Land Revenue.[1]

One question may be answered here. Can an economic holding be defined? By an economic holding is usually meant an area of land which will produce enough for the support of the cultivator and his family in reasonable comfort. It must have some facilities for irrigation.[2] But it must be made plain that there are great difficulties in attempting to define as a whole the size of economic holdings for a vast and varied area such as India. Allan rightly observes that the question cannot be 'answered according to any general principle or definite formula; it is always a question of fact the answer to which must vary according to the circumstances of each case'.[3] It will vary with the economic conditions of the area: a holding which is economic in Bengal will be certainly uneconomic in Rajputana. It will vary with the skill of the cultivator: a holding which will be economic for a Jat or a Kurmi will be uneconomic for a Brahman or a Rajput. Again, the size of the holding will differ with the standard of comfort to which the cultivator is accustomed. Hence it is scarcely an exaggeration that there are as many 'economic holdings' as there are cultivators—or at least, as there are classes of cultivators.[4] Nevertheless, soil, rainfall, irrigation, cropping, out-turn, prices, rent, the skill of the cultivator, and the size of the family, are some of the factors on the basis of which the size of an economic holding may be calculated. This would be a laborious task, involving a number of assumptions and calculations.

No doubt it is difficult to define an economic holding precisely, nevertheless it is generally admitted that the majority of the cultivators possess uneconomic holdings. Keatinge is of the opinion that 'in the Deccan, an ideal economic holding

[1] ch. vii.

[2] For definitions of an economic holding see KEATINGE, G. F., *Rural Economy in the Bombay Deccan*, pp. 52–3; MANN, H., *Land and Labour in a Deccan Village*, vol. ii, p. 43.

[3] BLUNT, op. cit., p. 131.

[4] ibid., p. 132.

would consist of (say) forty or fifty acres of fair land in one block with at least one good irrigation well'.[1] Professor Stanley Jevons, with reference to conditions in the United Provinces, considered a size of about thirty acres suitable for a model holding. As we have seen, the majority of the holdings are far below the size of the ideal holding. Hence the creation of economic holdings to ameliorate the ryot's economic position would entail the removal from the land of a large proportion of the population. Such a solution under present conditions is practically impossible. Therefore to improve the condition of the ryots in India it is necessary to attack the problem along many lines. Some of the directions in which improvement may be sought will be suggested in the following pages.[2]

The Geographical Distribution of Industries

Another feature of the occupational distribution of population, which affects the system of public finance in India, is the concentration of modern large-scale factories, works and plantations, in one or two definite areas. The most important large-scale industries are mainly concentrated in the Presidencies of Bengal and Bombay; the former is the centre of the jute industry, while in the latter about 70 per cent of India's cotton mills are located. Bengal and Bihar, on account of the presence of coal and iron ore, are the centres of India's iron and steel industries. Cawnpore, apart from Calcutta, is the most important industrial centre of northern India. Madras has some up-to-date factories. But the south as a whole is not much industrially developed on modern lines. The Punjab is mainly an agricultural province. The plantation industries are localized in Bengal, Assam and South India. The location of some of the important industries during 1935 is shown in the following table:

[1] KEATINGE, op. cit., pp. 52–3.

[2] See chs. vii, x and xi.

DISTRIBUTION OF INDUSTRIES (1935)[1]

Provinces	Textiles	Engineering	Minerals and metals	Chemical dyes, etc.	Paper and printing
Madras	55	73	19	19	66
Bombay	271	180	21	132	110
Bengal	146	241	12	126	107
United Provinces ...	42	37	13	31	32
Punjab	43	30	42	21	25
Burma	4	36	18	36	15
Bihar and Orissa ...	3	42	9	34	16
Central Provinces ...	20	24	...	47	14
Assam		18	2	12	6

The concentration of industries in one or two areas raises difficulties in the allocation of resources between the Provinces. It will be pointed out in a later chapter that the yield of the principal sources of revenue widely differs from Province to Province.[2] Indeed, the special claims of Bengal and Bombay are always based on their more rapid industrial advancement. It is not necessary to analyse the argument in detail here; but it may be observed that it would be a mistake to attribute the entire revenues for these industries to the industrial development of those Presidencies alone.[3]

Conclusions

We have now reviewed very briefly the chief characteristics of India, noting in particular the effects of the size, the population, and the occupations on the system of public finance in India. From this brief summary some broad conclusions can be drawn. In the first place, on account of the dominating position occupied by agriculture in the life of the people, the financial problems of the Indian Government are somewhat different from those of western countries. This must change the direction of public expenditure. Secondly the population

[1] *Statistical Abstract for British India*, 1938.

[2] Table VII, p. 104. [3] See chs. iii and iv.

problem undoubtedly is one of the most serious obstacles to increasing the quality and quantity of the social services supplied by the Government. There are some economists who hold that India can support an even larger population if the best means of production, distribution and consumption are adopted. Be this as it may, the possibilities of future industrialization are of small consolation to the present Government.[1]

Thirdly, much of the activity of the Government which helps the cultivator in his difficulties adds enormously to the happiness of the country as a whole.[2] Twenty years ago the authors of the Montagu-Chelmsford Reforms drew the following picture of the needs of the cultivator:

'The ryot and hundreds of thousands of his kind may be lifted from penury to comfort by a canal project costing millions of pounds. One of his constant needs is protection against the exaction of petty official oppressors. Improvements in seed or stock, manures, ploughs, wells; the building of a new road or a new railway; facilities for grazing his cattle or getting wood for his implements; the protection of his crop from wild animals, his cattle from disease and his brass vessels from burglars; co-operative banks to lend him money and co-operative societies to develop his market; the provision of schools and dispensaries within reasonable distance—these are the things that make all the difference to his life.'[3]

The two decades that have passed since the above passage was written have witnessed great growth. Schools have increased; agrarian legislation has been passed; the introduction of agricultural research and experimentation have placed improved methods of cultivation at the disposal of the cultivator; and the number of co-operative societies has increased.[4] Still so far only a fringe of the problems has been touched. Hence it is an imperative duty of the Government to assist and to protect the interests of the Indian ryot through a judicious system of public finance. 'The rural classes have the greatest stake in the country because they contribute most to its revenues.'

[1] See ch. xiii.

[2] *Report on Indian Constitutional Reforms*, Cmd. 9109 (1918), p. 114.

[3] See Cmd. 9109 (1918), pp. 114-15.

[4] See chs. vii and x.

§ 2. *CONDITIONS OF FINANCIAL REFORM*

(i) Possibility of Augmenting Government Revenues

No one can deny that the vast majority of the people of India are poor. Attempts have been made from time to time to estimate the annual *per capita* income of India, but the results, on account of the paucity of data and other peculiar difficulties, have not been reliable. Among the numerous estimates, Lord Curzon's estimate of Rs. 30 (1901), Mr Findlay Shirras' of Rs. 50 (1921), Professor Shah and Mr Khambhatta's of Rs. 74 (1921) and Dr Rao's recent estimate (1925–29) of Rs. 77·9 may be mentioned.[1] In most of these estimates there is a lack of definiteness and completeness. Nevertheless, these figures reveal the poverty of the masses in the country. It is commonly said that in face of the poverty of the people it is not possible to take a larger proportion of incomes in taxation. True, the masses are poor, but there are sections of population with large accumulations of wealth on whom the burden of taxation is very light. Reference may be made in this connexion to the remarks of Sir Walter Layton, the Financial Assessor to the Indian Statutory Commission:

> In spite of the wide-spread poverty in India, I see no reason to doubt that the public revenues of India can be substantially increased without taxation becoming intolerable, provided that its incidence is adjusted to the capacity of taxpayers to pay and that heavy additional burdens are not put upon primary necessities.[2]

Thus the cause of the present financial stringency is not to be found entirely in the inadequate total resources. With the development of improved means of transportation, large-scale industries, and the building of a network of canals, national prosperity is growing. Although generalizations are dangerous yet it can be safely asserted that productive capacity is growing steadily, notwithstanding periods of depression or agricultural calamity which encroach upon capital resources and lower the standard of

[1] Rao, V. K. R. V., *India's National Income* (Macmillan) 1939, p. 155. The book gives a useful summary of previous estimates at p. 10.

[2] *Indian Statutory Commission*, Cmd. 3569 (1930), p. 208.

life temporarily. From this point of view it is therefore quite correct to conclude that the wealth is there, the resources are there, but the system of taxation is unsatisfactory. What is needed is a readjustment of the system to make great wealth bear its share.[1]

Lines of Financial Reform

If the assumption stated above is justified an endeavour to secure larger revenues should include:

(i) more progressive distribution of taxation and burdens on the land;

(ii) reallocation of resources between the centre and provinces; and

(iii) co-ordination between provincial and local finance.

Scope for Retrenchment

The first of these considerations raises the question, Cannot the existing expenditure be so drastically reduced in certain directions as to provide the requisite revenue? It is outside the scope of this work either to express an opinion on the present scale of expenditure, especially military, which is the main target of criticism, or to criticize the efficiency and economy of administration. Nevertheless, it may be mentioned that the Government of India and Provincial Governments have made earnest efforts to cut down to the utmost expenditure in all possible directions.[2]

It may safely be asserted that the scope of retrenchment and economy is now extremely limited. With the introduction of responsible government in 1937, all possible economies are

[1] The above remarks should not be taken to imply that the financial system is the chief cause of poverty. The chief causes of poverty lie deeper in the economic and social system of the country. Two such causes, e.g. population and the uneconomic outlook, have already been mentioned in the preceding pages. See also ch. xii.

[2] See the *Inchcape Retrenchment Committee Report* (1922). See also chs. x and xi. The Congress ministers worked on a salary of Rs. 500 per month, though ministerial salaries before 1937 were about Rs. 3,000. The Governors of several Provinces have also recently voluntarily renounced a part of their salaries. There is also a move to reduce the salary and allowances of the members of the Indian Civil Service.

being made and extravagance and waste are being reduced to a minimum.

A word of caution is necessary. In the search for economy we must draw a distinction between false and true economy, between spending little and spending wisely. Economy should be understood not in the vulgar sense of spending little, irrespective of the return to the expenditure, but in the sense of the best utilization of available means.[1] Public expenditure would be a waste if it were reduced below the efficiency level.

A Change in Attitude towards Taxation

A better distribution of tax burdens can only be achieved through a change in attitude toward taxation. No longer should we regard taxation as a burden to be exacted from a victim for the support of an alien bureaucracy, but as a contribution to those authorities which have urgent and expanding services to administer for the social, moral and economic development of the country. The insistent demand for Indian constitutional development should not be a limitation to this idea. It is in this fundamental change of attitude, sustained by goodwill and co-operation between India and Britain, that the growth of the future financial resources of India depends. Racial prejudice, imperialistic ambition, or commercial or landed interests should not be a bar to the development of this conception.

Taxation is a Matter of Compromise

The reconstruction of the Indian financial system, reforms in taxation and in the land revenue and rental systems must be based upon principles of taxation. The fundamental principle of taxation demanding equality and uniformity of treatment is called the 'principle of equality or ability'. Perhaps no topic of public finance has aroused greater interest than the 'principle of ability'. Attempts have been made from time to time to suggest principles which may satisfy all the conditions for measuring the ability of an individual to pay taxation. But no solution so far has been arrived at on which there is complete unanimity of opinion; the reason being that taxation is often a matter of

[1] CANNAN, E., *History of Local Rates in England* (P. S. King) 2nd edition, 1912, p. 160.

expediency and convenience. What is an ideal rent or tax project from a theoretical point of view may be inadequate, impracticable, wasteful or politically inexpedient from a practical point of view. Hence 'nearly all taxation in practice is a compromise between two or more ideal positions'.[1]

In Appendix I we discuss some of the theories of taxation. Without repeating what has been said there we may state here that any single test of ability would either be politically inexpedient, financially inadequate or administratively impracticable. So the financial needs of a state need a manifold tax system. Such a tax system, to distribute the tax burden on an equitable basis, should be based upon the four tests of ability, viz. (i) income; (ii) net assets; (iii) expenditure as a test of ability; and (iv) the 'special ability' principle. In actual practice it is impossible to work out a tax system which would be just to all classes. So the object of the finance minister of a country should be to evolve a tax system in which the tax burden would fall fairly equally on all classes. For, as remarked elsewhere, the justice or injustice of taxation essentially lies in whether it is progressive or regressive.[2]

(ii) Principles underlying the Allocation of Resources between the Federation and Federating Authorities

Allocation of Functions

The problem of the division of taxing powers and functions between a federation and the states or federating authorities,[3] is necessarily one of difficulty. The problem would be simplified if it were possible to allocate separate sources of revenue to the two authorities which would fit in with the economic and financial requirements of each party. But this has not been found possible in actual experience in the financial systems of leading federations. For, as Sir Cecil Kisch has observed, it would be more or less of an accident if the revenues appropriate to federal and provincial exploitation yielded precisely the sums

[1] Lord Stamp, *The Fundamental Principles of Taxation* (Macmillan) 1936, p. 299.

[2] For a discussion of the theories of taxation, see Appendix I.

[3] Federation here corresponds with the Government of India; and Federating States with the Provinces and Indian States.

needed for the discharge of federal and provincial functions. Nature is not so accommodating. Hence there arises a need for compromises entailing concurrent jurisdiction in the realm of both taxation and administration.[1]

Since the test of the adequacy of taxing powers of the federation or the states depends upon the functions performed by each, let us start the study by stating the principles upon which the division of functions takes place. Economy, administrative convenience and efficiency have been the leading principles in the distribution of functions. These principles have guided the rival claims of centralization and decentralization. It will appear at once that certain functions can best be performed by the federation, while others are more suitable for the federating states or local authorities. Thus functions of an international character, like defence, foreign relations, foreign trade or commerce; or functions which are predominantly national in character, such as railways, currency and coinage, regulation of inter-state commerce and communication and so on, are definitely federal and should be administered by the central government. Similarly, functions such as education, law and order, police, agriculture, health, medical, are fit for the administration of the federating states or local authorities. It may, however, be mentioned that in some cases it may be desirable to secure uniform progress, to have state administration and federal legislation. We may also have concurrent administration (e.g. conditions of labour).

The actual distribution of functions in a federation is dependent upon a number of considerations. In some federations there may be extreme centralization; in others extreme decentralization. In the main, in most cases, the tendency has been along the lines indicated above. It is not possible to restrict rigidly the scope of federal and state functions since no Chinese wall exists between them. In practice, there must be some overlapping. But the broad principles of economy, administrative convenience and efficiency should always be a guide whenever any difficulty, in the concurrent zone of administration, arises.

[1] Sir Cecil Kisch in a Foreword to *Principles and Problems of Federal Finance*, by B. P. Adarkar (P. S. King) 1933, p. xii.

Distribution of Resources, Principles of Efficiency and Suitability

The rationale of the distribution of resources follows closely the principles adopted in the distribution of functions. Professor Seligman mentions three such principles: viz. the principles of efficiency, suitability and adequacy. Efficiency and suitability depend upon the nature of the tax and its administration. 'No matter how well-intentioned a scheme may be, or how completely it may harmonize with the abstract principles of justice, if the system does not work administratively, it is doomed to failure.'[1] The problems of efficiency and suitability really depend upon the choice between a wide or a narrow tax basis. Where efficiency demands national uniformity combined with effective administrative supervision, the tax basis must be wide. Similarly, where the tax varies with localities and its assessment requires the most exact knowledge of local conditions, a locally administered tax will be more efficient. Other taxes less local in character or less well fitted for national assessment, because of administrative difficulties, are obviously suitable for provinces (or states).

The principles of efficiency and suitability have led to the division of the sources of revenue in a country into three classes: (i) Sources of revenue assigned to the federation; (ii) sources of revenue assigned to the states; and (iii) concurrent sources of revenue in which both the federation and the states can tax within certain well-defined restrictions. Even this triple division of resources sometimes results in deficits either in the federation or the states; in such a case the deficit is made up either by federal subsidies or contributions from the states. To this we come in the next section. Here we shall briefly state the general scheme of distribution adopted in most federations.

In most federations we find that the exclusive federal taxes consist of indirect taxes such as customs and excise taxes; receipts from federal property; earnings from commercial monopolies like those of salt and tobacco; and receipts from commercial undertakings. In the last case the common practice

[1] SELIGMAN, E. R. A., *Essays in Taxation* (Macmillan) 1925, 10th edition, p. 378.

is to have separate budgets for railways, posts and telegraphs. The states generally have powers of direct taxation, such as taxation of incomes, property and inheritances, and state property. The concurrent tax zone is often composed of income-tax, corporation tax, death duties and excises. The practice, however, differs from federation to federation.[1]

The Principle of Adequacy

This brings us to the principle of adequacy. The principles of efficiency and suitability are primarily concerned with administrative efficiency. The principle of adequacy has three important aspects: (i) The apportionment of revenues between the federation and the states, (ii) the allocation of revenues (in a federation or a state) between different services, and (iii) the question of 'collection', i.e. some taxes may be collected by the federal authority, but shared between the federal authority and the states.

Together with the division of functions between the federation and the states a simultaneous division of resources becomes essential. The allocation of resources should ultimately rest upon the functions performed by each government. Here difficulties arise. First, the division of the sources of revenue, suggested above, though it satisfies the conditions of efficiency and suitability, often fails to fulfil the condition of adequacy. For the functions of the states are usually expanding and require larger resources and the sources of revenue assigned to them are often inadequate for their requirements. Second, the yield from the same source of revenue varies greatly in different states. Third, the needs of each state, on account of differences in economic and natural conditions and population are different.[2] Hence the allocation of the same heads of revenue to each state breaks down on the principle of adequacy. Therefore, there must be some heads of revenue which should be 'balancing factors' to correct inter-state inequalities.

[1] For an account of the financial practice in some Federations see ADARKAR, B. P., op. cit.

[2] See chs. iii and iv.

The Principle of Transferences

The ideal allocation of resources between the federation and the states should be in accordance with the principle of the 'national minimum' for people living in different states.[1] This can be achieved through transferences from rich areas to poor areas in a federal state. The basic reason for these transferences is to reduce inter-state inequality of incomes. It must be remembered that vast inequalities in the distribution of income between peoples living in various states is not conducive to the prosperity of a nation. The machinery of public finance, through a judicious policy of transferences, can be employed to correct such inequalities of incomes.

It is unfortunate that whenever an attempt is made to transfer resources from one area to another fierce wrangling takes place between the states. People think in terms of states or artificial provincial boundaries rather than in terms of peoples. The financial history of the Provinces in India shows that bitter jealousy was caused at the revision of each financial settlement.[2] The ideal of a well-operated system of federal finance should be to provide the national minimum to the people whether they live in one state or province or another.

The application of transferences cannot be easily achieved. It may be assumed that each state (or province) attempts to transfer its resources, within its borders, from the rich to the poor. The federal government should step in to fill in the gaps of unevenness between states caused by differences in natural conditions or population. Thus poor or backward areas, on account of deficiency of natural resources, heavy population or lack of capital resources, need special treatment. Apart from social considerations, the economic reasons for a federal government to discriminate between the various states are legitimate and clear. The burden of indirect taxes is always heavier on the poorer classes. For example, in India, the backward Province of Bihar, on account of the heavy pressure of population, contributes more in customs and excise than the other comparatively richer, but sparsely populated, Provinces. Special subsidies and subventions should be granted in such cases for

[1] See Appendix I. [2] See chs. ii, iii and iv.

developmental expenditure or for other objects to achieve the national minimum. In order that the subsidies or subventions may be properly utilized the federal government should exercise some supervision over the financial conditions of the recipient states.[1]

Allocation between Different Services

The other aspect of the principle of adequacy, namely, the allocation between different services, is extremely important. There must be allocation of resources between the different services, whether they are performed by the federal or state governments. The services performed by the state may be distinguished into two broad classes: (i) general public services and (ii) special public services.[2] The latter may again be divided into three classes: (*a*) services which can be provided by private enterprise but which the state provides to better advantage on account of administrative convenience and efficiency, e.g. free roads paid for by taxation; (*b*) services (e.g. poor relief, education, etc.) for which most taxpayers agree to contribute (as suggested elsewhere), on account of what may be called the 'social conscience'; and (*c*) services in the nature of public utility, e.g. railways, gas, electricity, etc.[3] Here the state restricts the powers of monopolies and often charges discriminating prices.

Let us begin by asking upon what considerations the state should distribute its revenues between these services? How much should it allocate for general public services, social services and public utilities? Clearly, in the first two cases the costs principle cannot operate; in the last, the concept of costs is of fundamental importance. We begin our analysis by saying that all economic activity depends upon the type of state. In dictatorships a disproportionate influence on the policy of the government by a small minority of persons may lead to a diversion of economic resources into different channels than in democratic countries. Nevertheless, in most countries the state

[1] The relation of Local Finance to Provincial Finance is discussed in §3 of this ch. See also ch. xi.

[2] See Appendix I.

[3] See BENHAM, F., *Economics* (Pitman) 1938, pp. 288–99.

tries to diminish inequality of incomes by spending on social services, such as education, public health, medical and poor relief.

In our daily economic life millions of private decisions and business decisions are made by individuals or business men between the different alternative courses of action open to them. One individual prefers one decision as compared with another. A man may decide to pass a week-end outside London instead of buying a suit. An entrepreneur controlling the policy of a firm may decide to increase its output and charge discriminating prices from the consumers. Such decisions are mostly determined as a result of a deliberate choice made after carefully considering, and rejecting, possible alternative courses.[1] They ultimately depend upon what economists call the concept of 'opportunity cost'.

In the distribution of public expenditure between various services, with a limited quantity of available resources, the statesman has to eliminate some expenditures and approve others. His choice is affected by two considerations: first, the inherent utility of the expenditure, on the basis of which it is placed on a list of *possible expenditures*; and second, from the standpoint of the utility of the expenditure under consideration as compared with the utility of other expenditures that are equally possible, on the basis of which it comes to be a *preferred* expenditure.[2]

The rationale of public expenditure, as stated above, is often difficult to put into practice. The statesman must make a vast multitude of decisions. He must decide how to distribute the available resources among the various services. He must decide how much to spend on the army, navy, education, public health, and hundreds of other services. A large part of the expenditure is fixed (e.g. the King's Civil List) or is the result of past actions (e.g. interest on war debts). Some expenditure is decided on the spur of the moment (e.g. war emergency expenditure), other is due to vested interests or in order to 'safeguard' the interests of 'minorities'. Nevertheless, most expenditure is the result of deliberate decisions.

[1] BENHAM, op. cit., p. 7.

[2] A. DE VITI DE MARCO, *First Principles of Public Finance* (Cape) 1936; Introduction by PROFESSOR LUIGI EINAUDI, p. 24.

The ultimate allocation is an extremely difficult task on which widely different opinions are held by different people. It may be claimed that one scheme is better than another. My own opinion, expressed with all due diffidence, is that a reasoned criticism requires a considerable study of economics and political science. Unfortunately, criticism in India is often based more on sentiment and prejudice than on informed judgements.

(iii) The Allocation of Resources between the Central Government and the Provinces

Allocation a Matter of Compromise

To evolve a system of financial allocation in India, in conformity with the principles of efficiency, suitability and adequacy, is an extremely difficult task. Constitutional, natural and economic considerations place insurmountable difficulties in its way. A system which would obviously secure efficiency and suitability would break down on the principle of adequacy. Moreover, a system that might suggest itself as the most acceptable would not satisfy the conflicting claims and counter-claims of the various Provinces. Hence financial allocation between the Government of India and the Provinces has always been a matter of compromise. Such 'compromises' are reflected in the system of 'doles' from the Centre to the Provinces or 'contributions' from the Provinces to the Centre or in the system of 'shared revenues'. In chapters ii and iii we study the history of provincial finance. Here we shall endeavour to ascertain some underlying principles which must be borne in mind in making a permanent choice in the allocation of revenue resources between the Provinces and the Centre. We do this by examining some of the main sources of revenue in India.

Allocation of the Principal Sources of Revenue

Land revenue is one of the most important sources of revenue in India. It must be administered by the Provincial Governments, for the system of land tenures, basis of assessment and types of settlement vary in different Provinces. The

Provincial Governments possess the most exact knowledge of local conditions upon which land revenue depends.[1] As agricultural productivity depends upon adequate water supplies the yield from land revenue is closely bound up with irrigation. Hence irrigation finance is also a suitable subject for provincial administration.[2] In fact, irrigation rates are collected along with land revenue. Excise duties on country spirit and intoxicants, on account of administrative convenience, are well fitted for provincial administration.[3] The two other heads of revenue where effectiveness of provincial administration would increase revenue are forests and stamps. Hence forest developmental policy needs provincial interest and supervision. Stamps are divided into two well-marked sub-heads, general and judicial; the former, to preserve uniformity of rates (in the case of commercial stamps), need central legislation but provincial administration. Judicial stamps, to increase effectiveness of administration, need provincial control. Both, however, should be provincial heads of revenue. This arrangement would secure uniformity of rates, effectiveness of administration and adequacy of resources to the Provinces; the Provinces having a free hand in adjusting court fee rates. Central administration in any of these heads of revenue would decrease efficiency of administration and yield.[4]

Just as provincial administration of revenues in some cases is superior to central administration, it may be expected that in some cases central administration will be superior to provincial. Customs, salt, railways, posts and telegraphs, opium or excises, by the very character of the tax or service, would undoubtedly be far more efficiently administered by the Central rather than Provincial Governments. The extreme difficulty of allocating the yield among the Provinces, the need for uniformity and central control and the use of the broadest tax jurisdiction, make them suitable for the Central Government.

Some doubts may arise regarding income-tax. Whether the proceeds are apportioned in whole or in part to the Provinces (or States), the collection, assessment and administration, to

[1] See ch. vii. [2] See ch. viii. [3] See ch. viii.
[4] See chs. vii and ix.

secure uniformity and efficiency, should be by the Central Government. The same reasons equally apply to super-tax, corporation tax and death duties. In modern India, through the working of economic forces, the income of the taxpayers has very little to do with the Province in which they happen to live. Thus receipts from the taxation of corporations (whose holdings are spread over the country) cannot be allocated to any Province. Hence to avoid the conflicts of tax-jurisdiction, inter-provincial jealousies and complications (e.g. the movement of labour and capital), these taxes should be collected centrally though the proceeds might be shared. The Provincial Governments, however, may be given the right to levy surcharges within a fixed percentage. The taxation of agricultural incomes, for reasons given in chapter vii, should be left with the Provincial Governments. As the tax revenue would be spent within the Province the dangers of excessive taxation should not be exaggerated.

Balancing Factors

The above allocation of resources, on theoretical grounds, appears to be sound. But on the principle of adequacy it fails. First, because the yield from land revenue is different in different Provinces.[1] Secondly, the functions of the Provincial Governments are expanding and their sources of revenue are almost inelastic. Thirdly, the needs of each Province on account of natural, economic, and population considerations are different. Hence, the above allocation is either inadequate to the needs or creates inter-provincial inequalities. Therefore, there must be some heads of revenue which should be 'balancing factors' to correct inter-provincial inequalities and to introduce an element of greater elasticity in provincial revenues. In short, certain resources should be transferred from the Central Government to the Provinces. The most important heads of revenue which can be admirable balancing factors are income-tax, excises on such commodities as salt, matches and tobacco, and the export duties, such as that at present levied on jute.

The allocation of the proceeds of taxation from the balancing

[1] See Table VII, p. 104. The table gives the comparative yield from the provincial sources of revenue.

factors depends upon varying considerations—political, economic, natural or social. The justice (or injustice) of the allocation would depend upon the weight attached to each consideration by the financier. This would vary with his discretion. However, the most important principle which should be the ideal of the financier is to transfer resources from the richer to the poorer Provinces in order to attain the national minimum. In translating this ideal into practice he must be guided, in India, amongst other factors, by (i) the state of its finances; (ii) natural resources; (iii) climate and rainfall; (iv) population; and (v) the state of its economic development. The distribution of the resources by the Central Government based upon these factors would fill in the gaps and inequalities resulting from artificial provincial boundaries or other considerations.

§ 3. *LOCAL FINANCE* [1]

Need for Co-ordination

Finally, there must be co-ordination in financial administration, resources and expenditure between local authorities and Provincial Governments. In a later chapter we shall see that with independent taxes, inadequate resources and growing local functions, local finance is inefficient and uneconomical. Efficiency and economy in local finance can be introduced by (i) developing the resources of local authorities and (ii) co-ordinating the resources of local authorities and Provincial Governments through a system of grants-in-aid. The theory of grants-in-aid will be found in chapter xii. There we try to show the main problems of local authorities, and by what methods they are to be solved. For the present, we are analysing the principles of local finance.

Onerous and Beneficial Services

In a discussion on the principles of local finance it is desirable to distinguish between national or onerous, and local or beneficial, services—a distinction to which adequate attention has not been paid in the field of local finance in India. This

[1] See ch. xii.

distinction, however, is highly important in the theory of grants-in-aid.

The Royal Commission on Local Taxation in England (1901) observed that services which are preponderantly national in character and generally onerous to the rate-payers are 'onerous', and services which are preponderantly local in character and confer upon rate-payers a direct and peculiar benefit more or less commensurate with the burden are 'beneficial'. The Commission further observed that the distinction cannot, it is true, be drawn with absolute and logical precision. In many cases it is plain enough, e.g. just as water rates are held to be payments for service rendered rather than taxes, so also it is clear that drainage works are a local benefit of a similar kind. But in other cases, the two elements are combined in different degrees, since almost all useful local expenditure is indirectly advantageous to the country at large.[1]

Professor Cannan distinguishes between onerous and beneficial services on the ground of the *benefit* which local expenditure confers upon rate-payers. An 'onerous' local service is one which is regarded as a burden because it is not worth to the local taxpayers what it costs them.[2] At another place he further explains the idea: 'Expenditure out of rates receives the name of "beneficial" if its direct effect is sufficient to more than counterbalance the opposite effect of the addition to rates, so that in spite of the addition to rates, it tends to cause an actual rise in the value of immovable property, while expenditure out of rates which depresses the value of property, is called "onerous".'[3]

[1] *Royal Commission on Local Taxation*, Cmd. 638 (1901), p. 12. As a result of the above distinction the Commission came to the conclusion that Poor Relief is a national service; Police and Criminal Prosecution are also predominantly national; and Education is also a national service in a high degree. The maintenance of Main Roads on the whole is a national service and will become more and more so with the increasing mobility of population and development of means of transportation and communication.

[2] CANNAN, op. cit., p. 168. [3] p. 180.

Principles of Local Finance

The classification of the local services into onerous and beneficial raises two important problems which have a bearing on the financial relations between the Provincial Governments and local authorities. These problems are:

(i) The equity of local rates; and
(ii) The financing of local services.

Each of these problems needs close attention.

Local finance differs in one fundamental respect from national finance. Though the object of a Government in levying a tax is to render services directly or indirectly to the taxpayer, yet, in the case of an individual it is impossible to establish a correlation between the amount of the tax paid and the amount of the benefit received. The essence of a tax, says Professor Taussig, 'as distinguished from other charges, is the absence of a direct *quid pro quo* between the taxpayer and the public authority'. In local taxation, however, in some cases, it is possible to measure the benefit received and to correlate this with the amount of the tax paid. Some local taxes are specially levied to benefit the inhabitants of particular localities.

While discussing the benefit and ability theories of taxation we observed that while the ability theory has a greater application in national finance, the benefit principle comes into play in local taxation. It should not, however, be inferred from the above statement that the principle of ability has no place in local finance. The principles of local finance correctly enunciated must contain both elements. The difference between the principles of national finance and local finance comes to this: whereas in national finance a greater weight should be given to the ability principle, in local finance a greater weight should be given to the benefit principle. Both the principles, in a judicious system of taxation, must supplement each other.[1]

The principles of local finance have been put by Professor Cannan thus:

(i) That every inhabitant of a district should be made to contribute according to his ability; and

[1] See Appendix I.

(ii) That everyone who receives benefit from local expenditure should be made to contribute in proportion to the benefit he receives.[1]

These two principles, applied to the same rate, are obviously incompatible; ordinarily the benefit conferred by any kind of Government expenditure is hardly in proportion to the ability of a taxpayer. But in local taxation it happens in practice that taxes on property benefit the persons in proportion to their ability to contribute. Everyone agrees that the supply of important beneficial services, e.g. water-supply, drainage, town-improvement, lighting, regulation of traffic, construction and maintenance of local highways, paths and bridges, should be paid for by each individual in proportion to the benefit secured by him. In practice, however, an actual measurement of the quantity of commodity or service taken is either impossible or difficult and expensive. To measure the quantity of roads consumed by a particular person or the street-lighting required by a person is impossible. Hence a tax on annual value is often levied by municipalities for financing some of the beneficial services. This assumes that the benefit received by a taxpayer is proportional to the value of property owned by him. Similarly it is thought that the value of property owned reflects his ability to pay the tax.

In some cases, for separate services, where accurate measurement is possible, separate charges are made. The proportional cost of service principle is illustrated where municipalities charge for water on the quantity of water consumed, viz. by fixing meters. But where the water rate is fixed in proportion to the rental value of property, the charge is progressive, as houses of small rental value evidently use proportionately more water than those of high.

On what principle should a local authority, it may be asked, fix its charges for beneficial services which are in the nature of public utilities? The costs of such services may be divided into two parts: (i) marginal costs, and (ii) fixed costs. Theoretical considerations enable us to say that each consumer should pay the marginal cost of the service incurred by the local

[1] CANNAN, op. cit., p. 159.

authority. In allocating fixed costs some difficulty arises. It is sometimes held that fixed costs should be met out of general revenue. This method is, I think, unsound; for there is no reason why those who do not consume the service should pay a subsidy for the supply of the service. It is fair, I think, that the users of services should pay the fixed costs in proportion to their use. The adoption of this principle would mean that every consumer should pay the marginal costs while those who consume a larger quantity of the service should pay more towards fixed costs than those who consume less. No doubt, in some circumstances (for example the supply of water in a tropical country) social considerations may demand that relatively rich people should pay for relatively poor people; but theoretically in the case of public utility services the best course is not to raise funds for the subsidy to be distributed among the poor in proportion to their consumption of a particular commodity.

The adoption of the above principle would not cause administrative inconvenience; for example, in the case of electricity the fixed costs may be allocated on the number of points a person may have in his house.[1]

Onerous services benefit not only the locality but the nation as a whole: for instance education. Local children receive the education but the nation is benefited. Under the present conditions of local finance in India either the residents of poor areas are not provided with the necessary minimum of onerous services or they are required to pay disproportionately higher taxes than they should be required to pay. The system creates inequalities of local taxation both between individuals and between districts.

To make local taxation more equitable as between individuals and districts expenditure on onerous services should be borne jointly by Provincial Governments and local authorities. The result of this change would be that in applying the principle of ability in local finance, we should take into consideration

[1] Incidentally, it may be mentioned here that the state should help the poor in other ways, e.g. free provision of elementary education, rather than by distributing the fixed costs on the general body of taxpayers.

the actual circumstances of each locality and transfer any part of the local burden to provincial funds which the locality is unable to bear. The transfer of local burdens to provincial funds would bring about a fairer distribution of tax burdens between both individuals and districts.[1]

Plan of the Work

The plan of the work will be as follows. In the first place an account will be given of the history of provincial finance.[2] Secondly, a more detailed account will be given of the Montagu-Chelmsford Reforms, the Meston Settlement and provincial autonomy.[3] This will be followed by an attempt to examine the main heads of revenue and expenditure and their effects on the life of the people.[4] Next, the problems of local taxation will be examined.[5] Finally, an attempt will be made to suggest, however tentatively, the future policy to be pursued by the Government so that some of the fundamental obstacles accountable for the arrested economic development of India may be removed.[6]

[1] See ch. xii for further discussion. [2] ch. ii. [3] chs. ii, iii, iv and v.
[4] chs. vi, vii, viii, ix and x. [5] ch. xii. [6] ch. xiii.

II

HISTORY OF PROVINCIAL FINANCE (1833–1919)

A knowledge of the history of the financial settlements between the Central and Provincial Governments is necessary in order to appreciate the nature and extent of the changes brought about by the reforms of 1919. The historical background has an important bearing on present and future financial arrangements and cannot be altogether ignored. No doubt it is impossible to correct past mistakes, and it is useless to revive old controversies—yet a knowledge of the past ensures foresight and care in shaping the future policy of the country. I shall, therefore, briefly trace the history of the financial settlements prior to 1919 in order to understand the changes brought about by the Reforms.

§1. *CENTRALIZED SYSTEM OF FINANCE (1833–71)*

The Charter Act of 1833

In the field of provincial finance, prior to 1871 both revenue and expenditure were rigorously centralized in the Central Government. The centralized system of finance was the necessary result of the centralized system of administration. During this period (1833–71) no Provincial Government could keep any part of its collections and it could not undertake any expenditure without the previous sanction of the Government of India.

The Charter Act of 1833 is a landmark in the history of Indian administration and finance. It introduced a system of centralized administration and vested the superintendence, direction and control of the whole civil and military government and revenues in the Governor-General of India in Council. In regard to finance it was laid down that, without the previous

sanction of the Governor-General in Council, the Provinces were not to spend the revenues allowed to them in creating any new office, or granting any salary, gratuity or allowance.[1] This rigorous control of the Central Government in provincial financial matters is described by the Strachey brothers in the following words:

> The Local Governments (i.e. Provincial), which practically carried on the whole administration of the country, were left with almost no powers of financial control over the affairs of their respective provinces, and no financial responsibility. Everything was rigorously centralized in the Supreme Government, which took upon itself the entire distribution of the funds needed for the public service throughout India. It controlled the smallest details of every branch of the expenditure; its authority was required for the employment of every person paid with public money, however small his salary; and its sanction was necessary for the grant of funds even for purely local works of improvement, for every local road, and every building, however insignificant.[2]

Political and military exigencies made it difficult to draw exact lines between the functions of the Imperial and Provincial Governments. In fact the whole tendency was towards the centralization of administration. The increasing ease and rapidity of the means of communication, the spread of the use of the

[1] So rigorous was the control that the court of directors strongly condemned the action of Mr A. Ross, the acting Governor of the North-Western Provinces, who, in anticipation of the sanction of the higher authorities, had abolished three custom houses in the interior of the Province. The dispatch concluded in these strong words: 'Such is the sense of the extreme want of judgement manifested by Mr Ross on this occasion that, supposing he still continued to exercise the functions of government in the Presidency of Agra, we should have come to the conclusion of cancelling his appointment. In exercise of those powers we deem it necessary to direct that the administration of the Government of Agra be never again, under any circumstance, delegated to Mr Ross.' See *Dispatch of the Court of Directors to the Government of India, 1st February, 1837*, quoted in BANERJEE, *Provincial Finance in India*, p. 16.

[2] STRACHEY, SIR JOHN and LT.-GEN. RICHARD, *Finances and Public Works of India (from 1869 to 1881)* (Kegan, Paul, Trench & Co.) 1882, p. 134.

English language, the material development of the country and the increasing interest taken by Parliament in the details of Indian administration were some of the circumstances which favoured centralization.[1]

Defects of the System

The highly centralized system of finance was open to a number of gross abuses. The Provincial Governments administered the country but had no financial responsibility. This divorce of financial responsibility from administration resulted in extravagance. Economy comes with responsibility. When the responsibility for finding revenues rested with the Government of India, the Provinces, as was natural, asked for as much as they could. The Provinces thought that 'they had a purse to draw upon of unlimited, because unknown, depth; they saw, on every side, the necessity for improvements; their constant and justifiable desire was to obtain for their own provinces and people as large a share as they could persuade the Government of India to give them out of the general revenues of the empire; they found by experience that the less economy they practised, and the more importunate their demands, the more likely they were to persuade the Government of India of the urgency of their requirements. In representing and pressing those requirements, they felt that they did what was right, and they left to the Government of India, which had taken the task upon itself, the responsibility of refusing to provide the necessary means.'[2]

Thus the distribution of the funds was based not upon any fixed principle, nor on the resources, needs or expenditure of the Provinces, but according to the relative claims and clamour of each Provincial Government on the purse of the Government of India. The result, in the words of General Richard Strachey, was that 'the distribution of the public income degenerates into something like a scramble, in which the most violent has the advantage, with very little attention to reason'.[3]

[1] See *Report of the Royal Commission upon Decentralization in India*, Cmd. 4360 (1908), par. 47.

[2] STRACHEY, op. cit., pp. 136–7.

[3] ibid., p. 137.

Moreover, the Government of India in the absence of an efficient machinery of audit and the vast area of the country could not exercise an effective control over provincial expenditure. A careful system of audit and accounts had hardly developed. The budget grants were never carefully prepared or checked. In brief, as Dr Ambedkar puts it, so long as the Government of India remained without an appropriation budget and a centralized system of audit and account, it continued to be only a titular authority in the matter of financial control, and the Provinces, though by law the weakest of authorities in financial matters, were really the masters of the situation.[1] Thus the centralized system of finance developed financial irresponsibility and put a premium on inefficiency and extravagance.

India Councils Act (1861)

In 1858, as a result of the Mutiny the administration of India passed from the East India Company to the Crown. The final control of the finances now vested in the Secretary of State for India. So far as the internal control was concerned the India Councils Act (1861) did not modify the control of the Central Government over provincial financial matters. Centralization was still the most conspicuous feature of Indian administration.

A Period of Deficits

The financial needs of the country, however, on account of the huge deficits and debts left by the Company and the fast-growing public needs, required large sums to maintain financial equilibrium. The situation became extremely acute. In spite of the drastic economy in expenditure and the improvements in the machinery of financial administration, Mr James Wilson, the Finance Member, could not restore financial equilibrium. Mr Wilson in summing up the financial position in his financial statement for 1860-1 said: 'We have a deficit in the last three years of £30,547,488: we have a prospective deficit in the next year of £6,500,000; we have

[1] AMBEDKAR, B. R., *The Evolution of Provincial Finance in British India* (P. S. King) 1925, p. 27.

already to our debt £38,410,755.'[1] It is these Imperial deficits which suggested a policy of financial decentralization.[2]

§ 2. *FINANCIAL LANDMARKS IN THE LATER NINETEENTH AND EARLY TWENTIETH CENTURIES*

Lord Mayo's Reforms (1870)

From 1861 to 1870 eminent public administrators held divergent views regarding the transfer of the control of financial responsibilities from the Imperial to Provincial Governments.[3] On December 14, 1870, Lord Mayo issued the famous Financial Resolution in which he proposed to enlarge the responsibility and control of the Provincial Governments in respect of the details of their own expenditure. Lord Mayo said: 'I believe, as I have repeatedly said, that if we place administration of portions, both of our revenue and expenditure, in the hands of the local Governments, it will lead to economy, to increased responsibility, to the avoidance of much administrative difficulty, and above all, it will enable the rulers of the country gradually to institute, in various parts of the Empire, something in the shape of local self-government, and will eventually tend to associate more and more the natives of this country in the conduct of public affairs.' Services like jails, police, education, roads and civil buildings, were transferred to the charge of the Provincial Governments. To meet the cost

[1] See *Financial Statement*, 1860–1. Speech of Mr James Wilson, February 18, 1860, p. 6 (India Office Library).

[2] During the period 1834–5 to 1857–8, there were seventeen years of deficit budgets and only seven years of surplus. The public debt of India during 1834 to 1857 increased from £41,350,952 to £59,441,052.

[3] As early as 1861, Mr Laing, the successor of Mr James Wilson, advocated financial decentralization. Mr Laing observed:

'It is most desirable to break through the system of barren uniformity and pedantic centralization which have tended in times past to reduce all-India to dependence on the *bureaux* of Calcutta, and to give to local Governments the power and the responsibility of managing their own local affairs.' See *Financial Statement*, 1861–2. Speech of Mr Samuel Laing, Finance Member, April 16, 1862, p. 89. (*Financial Statements*, 1860–1 to 1873–4. India Office Library.)

of these services (£4,514,332) on the basis of the figures of 1869–70, Lord Mayo transferred the excise receipts of £2,000,000 and a lump sum assignment of £1,500,000; the remaining million pounds was to be raised by the Provincial Governments by extra local taxation.[1]

Advantages of the Scheme

Lord Mayo's scheme was the first step in financial decentralization of the country. The scheme, it was expected, would produce greater care and economy in public expenditure, import an element of certainty into the financial system and would ultimately result in creating harmonious feelings between the Central and Provincial Governments. 'Above all,' wrote Lord Mayo, 'local interest, supervision and care, are necessary to success in the management of funds devoted to education, sanitation, medical charity and local public works. The operation of this resolution in its full meaning and integrity will afford opportunities for the development of self-government, for strengthening municipal institutions, and for the association of natives and Europeans, to a greater extent than heretofore, in the administration of affairs.'

Lord Mayo's scheme of decentralization was prompted by two objects, namely relieving the Imperial Government from the financial chaos caused by constant deficits, by developing local sources of revenue, and secondly developing a sense of responsibility in Provincial Governments by the economical management of their finances.[2] The second object was based upon the elementary principle of public finance that tax administrations and appropriation must, as far as possible, go together. That both of these results were happily realized can hardly be challenged by any critic of the scheme. A study of the provincial budgets between 1871–2 to 1876–7 shows that surpluses outnumbered the deficits both in frequency and magnitude and even the deficits could easily have been met

[1] See BANERJEE, P., *Provincial Finance in India* (Macmillan) 1929, p. 62.

[2] Between 1860 and 1870 the three Indian Finance Members could only show *three* surplus years, in spite of constant enhancement of taxation, rigid economy and retrenchment.

from the accumulated balances of the past. The Imperial Government directly gained an annual relief of £330,801; besides there was an improvement in the efficiency of the services transferred to the charge of the Provincial Governments.

Defects of the Scheme

Perhaps the greatest defect of Lord Mayo's scheme was that the settlement of 1871 was based on the actual expenditure of the Provinces for 1870–1. The expenditure of that year, on account of past inequalities, was very unequally distributed. The expenditure of Bombay, for example, on the services transferred was more than double that of Madras and the United Provinces, and nearly treble that of Bengal.[1] The Central Provinces and the Punjab were also far behind Bombay in the scale of their expenditure. Mr Gokhale in his evidence before the Welby Commission, 1896, said: 'The fact is that these inequalities are a legacy from the pre-decentralization period, when the expenditure of different Provinces was determined . . . not by the resources or requirements of those Provinces, but by the attention that their Governments succeeded in securing from the Central Government, i.e. by the clamour that they made. And when the first step was taken in 1870 in the matter of decentralization, the level of expenditure that had been reached in the different Provinces was taken as the basis on which the contracts were made, and the inequalities that then existed were, so to say, stereotyped. I think it is high time that an effort should be made gradually to rectify these inequalities.'[2]

Thus were laid the foundations of inequalities in provincial finance—inequalities which were stereotyped with each step in the financial decentralization of the country. The successive financial settlements not only did not remove the inequalities of the past but accentuated these disparities, with the result that the task of the future financiers has become extremely difficult. The policy of doles and contributions to meet the

[1] See GYAN CHAND, *The Essentials of Federal Finance* (Oxford University Press) 1930, pp. 36, 37.

[2] Evidence of Mr G. K. GOKHALE, *The Welby Commission Report*, Vol. III, p. 217, Q. 18094. Cmd. 130 (1900).

exigencies of the times (besides for some other reasons), has made it impossible to do inter-provincial justice in the assignment of funds. Thus some of the most difficult present-day problems of financial adjustment of burdens and resources among the Provinces owe their origin to the days of extreme centralization. The authors of the Reforms and the Federal Constitution had to face extreme difficulties in solving the financial problems relating to inter-provincial claims and counter-claims. This, however, is to anticipate the discussion.

Lord Lytton's Reforms (1877)

The next step in financial decentralization was taken by Lord Lytton in 1877. No doubt Lord Mayo's Government had effected a large reform, yet it suffered from the defect that the services which it left to the management of the Provinces were few. It also did not give the Provinces an effective inducement to develop the revenues collected in their territories. Moreover, the rigidity of the system of assignments was not favoured by the Provinces, because while the revenues collected in their territories were increasing the assignments allotted to them did not increase. It was also recognized that in order to encourage economy the interference of the Government of India in the details of provincial administration should decrease. That economy and good management go together was clearly realized by Sir John Strachey, who in his financial statement of 1877–8 stated that good management of finance was to be had 'not by any action which gentlemen of the financial department, or by any other department of the Supreme Government, can take whilst sitting hundreds or thousands of miles away in their offices in Calcutta or Simla; not by examining figures and writing circulars; but by giving to the Local Governments . . . a direct and, so to speak, a personal interest in efficient management.'[1]

Under the settlements the financial control of services like land revenue, excise, stamps, law and justice and general administration was transferred to the Provincial Governments; and at the same time the revenues raised from law and justice,

[1] STRACHEY, op. cit., p. 143.

excise, and the license (now income) tax was handed over to the Provinces. But as the departmental receipts from the services committed to the Provinces fell short of their requirements, the margin of deficit had to be met by an assignment. This was determined after taking into account the normal yield of the assigned revenues and their normal rate of growth. Further, any increase over the revenue, as it stood at the time of assignment, was shared between the Government of India and the Provinces—the former had also to bear a share of any decrease.[1] An important departure, however, was made with Burma and Assam (1879) which, instead of fixed assignments, were given a share of land revenue. Madras refused to accept the new system and continued to receive its revenue under the settlement of 1871.

Settlements of 1882

These settlements remained in force between the years 1877–8 to 1881–2. In 1882 fresh settlements were made with all the Provinces. The most important principle introduced by the settlement of 1882 was that, instead of giving to the Provincial Governments fixed grants of revenue they were granted the entire yield of some of the sources of revenue and a share in certain Imperial sources of revenue. Here we meet for the first time the classifications of revenue into 'Imperial', 'Provincial' and 'Divided'. The receipts from customs, salt, opium, post office and telegraphs, remained wholly Imperial. The income from forests, excise, license (income) tax, stamps and registration were divided equally between the Government of India and the Provinces; while the income classified under the head 'Provincial Rates' was made entirely provincial and 'local'. Besides the departmental receipts from law and justice, public works and education were also provincialized. The bulk of the income from railways and irrigation remained Imperial.[2] Along with this division of incomes there was also a division of expenditure, which, generally speaking, followed the incidence of the corresponding heads of receipts. But as the expenditure devolving on the Provincial Governments was larger than the

[1] See Cmd. 4360 (1908), p. 27. [2] ibid., p. 28.

revenues assigned to them, the difficulty of adjusting means to needs remained. Hence the excess of provincial expenditure was made up by assigning to each Province a percentage of land revenue, which otherwise was an Imperial source of revenue.

By these settlements the Provincial Governments were given a direct interest not only in the provincial sources of revenue but also in the divided heads raised within their jurisdiction. The settlement also harmoniously united, to a considerable extent, the financial interests of the Central and Provincial Governments, which now not only shared the receipts but also the expenditure on certain heads. The system of divided heads remained the most important feature of provincial finance till it was abolished by the Reforms of 1919.

Defects of Quinquennial Settlements

The settlements of 1882 were quinquennial, and accordingly the provincial settlements were revised in 1887, 1892 and 1897. At these revisions no change of principle was introduced; except that as the shares of divided heads were not sufficient for the growing needs of the Provinces, they received, in addition, a special fixed assignment adjusted under the land revenue head.[1]

The main object of the quinquennial settlements (as compared with the annual) was to introduce an element of greater financial stability for the Provinces; but in actual practice the provincial settlements caused much irritation and friction between the Central and Provincial Governments. The most important cause of bitter feelings between the two authorities was the resumption of the provincial surpluses by the Government of India at the close of each quinquennial settlement. The periodical revisions encouraged extravagance rather than economy, and introduced an element of uncertainty in place of stability. A trenchant criticism of the settlements was given by Sir A. Mackenzie, the Lieutenant-Governor of Bengal, in his speech in the Imperial Legislative Council in 1896. He said: 'I deprecate the way in which these quinquennial revisions have too frequently been carried out. The provincial sheep is summarily thrown on its back, close clipped and shorn

[1] See Cmd. 4360 (1908), par. 58.

of its wool and turned out to shiver till the fleece grows again. . . . The normal history is this; two years of screwing and saving and postponement of works, two years of resumed energy on a normal scale, and one year of dissipation of balances in the fear that, if not spent, they will be annexed by the supreme Government at the time of revision.'[1] Finally, the quinquennial settlements crystallized the financial inequalities started in 1871, as no attempt was made in them to bring the provincial expenditure on to a common footing of equality.

Quasi-permanent Settlement (1904)

The year 1904 witnessed an important departure—the introduction of quasi-permanent settlements—in the history of provincial finance. Under this system the revenues assigned to a Provincial Government were definitely fixed, and were not subject to alteration by the Central Government save in the case of extreme and general imperial necessity, or unless experience proved that the assignment made to the Province was disproportionate to its normal needs.[2]

Broadly speaking, the Government of India received the whole of the revenue derived from opium, salt, customs, mint, railways, posts and telegraphs, the military receipts, and the tributes from Indian States. The revenues derived from registration, ordinary public works, police, education, medical service, courts and jails, were entirely provincial. The receipts from land revenue, excise, stamps, income-tax and forests were divided, generally in equal proportions, between the Imperial and Provincial Governments. The bulk of the provincial revenues was derived from the divided heads.

Along with this division of revenues there was also a division of expenditure. The Central Government was responsible for all the expenditure in connexion with defence, railways, posts and telegraphs, interest on debts, and home charges. The Provincial Governments were responsible for the whole of the expenditure incurred in connexion with land revenue, general administration, registration, law and justice,

[1] Quoted in GYAN CHAND, op. cit., p. 56.
[2] See Cmd. 4360 (1908), par. 59.

police, jails, education, medical services, stationery and printing and provincial civil works. The expenditures on stamps, excise, income-tax and forests were equally divided, while the incidence of irrigation expenditure followed that of the receipts.[1]

But as the expenditure of the Provincial Governments generally somewhat exceeded the assigned revenues, the difference was made up by three methods:

(i) A fixed assignment, as formerly, under the land-revenue head.

(ii) Initial lump sum grants granted principally with the object of enabling the Provinces to undertake works of public utility.

(iii) Special grants granted for the development of police reform, agriculture and education.

Another important change with regard to famine expenditure was introduced. Till 1904 the liability for famine relief was provincial and the Government of India only stepped in to help the Provinces when their resources were exhausted. Hereafter a new famine scheme was devised by which the Government of India, year by year, placed a specific amount (roughly calculated with reference to the famine liabilities of each Province) on which the Provincial Governments could draw in time of famine without retrenching on their normal resources. When this fund was exhausted the famine expenditure was divided equally between the Central and Provincial Governments; and in the last resort the Government of India promised further help from the imperial revenues.[2]

On the basis of the budget figures for 1903–4 it was found that the aggregate provincial expenditure represented less than one-fourth of the total expenditure of India as a whole, while the expenditure of the Government of India (which included the expenditure for the army and the home charges) exceeded three-fourths of the aggregate. These proportions of expenditure, subject to some adjustment, were taken as the basis for

[1] ibid., par. 61.

[2] ibid., par. 62. In 1917 this arrangement was further simplified and famine expenditure was made a 'divided' head—the expenditure being borne by the Central and Provincial Governments in the proportion of three to one. See Cmd. 9109, par. 108. See also chs. iii, iv and ix.

the division of revenue between the Central and Provincial Governments.[1] Thus the following division of revenue and expenditure between the Central and Provincial Governments in the divided heads of revenue was decided upon:

PROVINCE	IMPERIAL	PROVINCIAL
Bengal, United Provinces	3/4	1/4
Bombay, Madras, Punjab, Burma ...	5/8	3/8
Central Provinces, Assam	1/2	1/2

The Advantages of the Quasi-permanent Settlements

The quasi-permanent settlements were a great improvement upon the old system of quinquennial revisions. Under the old system the Provincial Governments were always exposed to the uncertainties and risks of an unfavourable settlement at the end of every five years. With this sword of Damocles always hanging over their heads, it was impossible to have a liberal outlook in financial policy. Any regular and systematic plan of provincial development along well-considered lines, under such conditions, was not possible. The new system changed this by giving the Provincial Government a more independent position, and a more substantial and enduring interest in the management of its resources than had previously been possible.[2] The Government of India also improved its relations with the Provincial Governments by avoiding the bitter quinquennial controversies in the assignment of revenues.[3]

Permanent Settlements (1912)

The financial relations between the Central and Provincial Governments were examined by the Decentralization Commission (1909) but the Commission did not propose any radical change in the system. The question, however, received the

[1] Some of these adjustments were: (i) larger assignments to backward Provinces, (ii) special grants for carrying out works of improvement or administrative reforms.

[2] See Cmd. 4360 (1908), par. 60.

[3] In 1904–5 the settlements with the Provinces of Bengal, Madras, Assam and the United Provinces were declared to be quasi-permanent. Bombay and the Punjab obtained quasi-permanent settlements in 1905–6. In 1906 the settlement of the Central Provinces was made quasi-permanent. Burma came within the pale of quasi-permanent settlement from 1907.

TABLE III

PROVINCIAL SURPLUSES AND DEFICITS

(IN RUPEES)

PROVINCES	1904–5	1905–6	1906–7	1907–8	1908–9	1909–10	1910–11	1911–12
Central Provinces[1] ...	– 7,01,000	32,35,000	17,50,607	– 9,30,617	– 30,97,865	7,21,755	2,80,556	12,14,573
Burma	– 15,91,796	– 26,13,890	18,90,516	– 31,29,590	– 20,60,678	25,15,371	19,00,297	– 12,60,040
Assam[2]	– 2,69,316	– 37,20,027	– 2,00,140	– 25,96,682	– 23,57,687	5,49,270	55,39,698	52,18,802
Bengal	– 12,52,818	– 19,52,312	– 18,77,455	– 22,56,994	– 13,30,371	32,74,065	39,60,612	82,96,233
United Provinces ...	– 8,69,099	– 28,79,192	7,95,600	– 35,87,066	– 10,07,260	20,45,221	36,35,904	1,44,240
Punjab	47,94,387	– 27,96,052	– 6,61,214	– 24,08,818	– 15,76,981	13,00,559	41,99,121	33,98,055
Madras	– 14,02,344	2,20,328	12,17,745	– 44,992	20,25,109	12,66,326	23,16,383	29,38,502
Bombay	43,96,000	– 42,892	17,52,202	– 3,08,925	– 26,18,926	71,37,996	75,85,460	– 5,41,411

[1] Includes Berar since 1906.

[2] Eastern Bengal and Assam since 1906.

TABLE IV

IMPERIAL GRANTS-IN-AID TO THE PROVINCES

(IN RUPEES)

PROVINCES	1904–5	1905–6	1906–7	1907–8	1908–9	1909–10	1910–11	1911–12
Central Provinces[1] ...	28,53,710	69,57,793	1,10,500	27,52,010	29,03,668	35,88,270	34,65,500	20,80,845
Burma	5,67,500	18,45,000	72,19,000	6,82,000	2,15,253	18,20,952	42,32,742	36,05,164
Assam[2]	...	33,62,916	3,27,294	2,80,030	23,58,947	44,64,435	46,08,965	61,00,732
Bengal	24,794	48,06,984	4,75,548	13,62,634	41,57,393	57,53,692	61,37,013	1,11,31,276
United Provinces ...	1,36,600	40,36,307	76,41,697	98,79,667	87,70,345	16,24,329	45,13,729	31,36,107
Punjab	75,26,436	24,67,579	42,09,531	55,41,529	60,37,990	58,39,014	95,92,844	31,01,681
Madras	7,00,946	44,30,714	99,80,400	94,73,304	7,04,885	6,13,941	36,91,426	50,08,889
Bombay	1,03,12,928	34,27,325	40,24,512	45,74,284	57,26,162	57,97,603	1,20,09,360	49,35,159
Total ...	2,21,22,914	3,13,34,618	3,49,82,982	3,45,43,458	3,08,74,643	2,95,02,236	1,54,75,360	3,90,99,853

[1] Includes Berar since 1906.

[2] Eastern Bengal and Assam since 1906.

TABLE V

PROVINCIAL SURPLUSES AND DEFICITS

(IN RUPEES)

PROVINCES	1912–13	1913–14	1914–15	1915–16	1916–17	1917–18	1918–19
Central Provinces	50,85,246	18,81,245	−65,44,416	−13,836	42,35,704	48,70,517	92,01,121
Burma	88,74,174	9,14,026	−37,29,808	18,96,621	94,27,702	1,20,67,708	48,73,587
Assam	36,10,494	−22,17,691	−45,50,789	6,58,812	60,44,904	28,00,634	4,35,872
Bengal	1,47,05,270	4,80,842	−39,67,607	10,28,156	37,08,838	52,80,082	7,32,237
Bihar and Orissa	70,22,199	−9,20,062	−18,70,264	11,33,562	59,19,907	71,76,786	36,43,564
United Provinces	95,88,749	50,704	−46,11,080	−9,73,090	34,27,808	−22,68,311	36,86,945
Punjab	74,11,069	−6,92,512	−37,30,641	−11,33,541	5,00,995	−6,95,216	11,85,930
Madras	43,30,275	−52,98,411	−12,07,754	3,18,508	25,71,241	10,42,303	−9,72,354
Bombay	70,83,281	15,58,566	−26,39,924	−9,51,099	1,22,434	6,11,321	16,81,066

attention of Lord Hardinge's Government, and the quasi-permanent settlements of 1904 were made into 'permanent settlements' from 1912. The permanent settlements did not introduce any change of principle in the allocation of resources; except that they reduced the fixed assignments and gave the Provinces larger shares in the growing sources of revenue. These settlements continued till the Reforms of 1919 when provincial finance entered on an entirely new phase.

The financial position of the Provinces during the period is shown in Tables III–V.

Defects of the Permanent Settlements

With the Reforms (1919) the *basis* of financial relationship between the Central and Provincial Governments underwent a radical change. Till 1919 there was the 'statutory hypothecation of all Indian revenues to all-India needs'.[1] The Provincial Governments could not claim any of the revenues, though raised within their jurisdiction, as entirely belonging to them. Before, however, we discuss the changes brought about by the Reforms, it is worth while to mention some of the chief defects of the then existing system. Three defects of the system stand in prominence:

(i) The strict control and supervision by the Central Government of provincial expenditure.

(ii) The complete control by the Central Government of all taxation raised in British India.

(iii) And lastly, the Provincial Governments had no independent powers of borrowing.

The strict control by the Government of India in the *details* of provincial expenditure was due to the fact that through all the stages of financial evolution from 1833 to 1919, the financial settlements *were based not on provincial revenues but on provincial needs.* This inevitably led to a close supervision from the Central Government because 'the Government of India could not allow a Province to go bankrupt'.[2] Moreover, as the Government of India took a share in the divided heads of revenue, its share in the revenues was dependent upon its own competing needs and

[1] See Cmd. 9109 (1918), p. 93. [2] ibid., p. 92.

the needs of the Province. Thus there was a distinct desire of the Government of India to keep down provincial expenditure. Similarly, in raising revenues the Government of India had to interfere in details of provincial administration to see that its share was not diminished by the negligence or inefficiency of provincial administration. Such an arrangement was clearly incompatible with the spirit of the reforms. 'The existing settlements', observed the authors of the reforms, 'are an undoubted advance upon the earlier centralized system, but they constitute no more than a half-way stage. If the popular principle is to have fair play at all in Provincial Governments, it is imperative that some means be found of securing to the Provinces entirely separate revenue resources.'[1]

Again, the Provincial Governments had no independent powers of taxation. Section 79 (3) (*a*) of the Government of India Act (1915) prohibited a Provincial Government, without the previous sanction of the Government of India, from considering 'any law, affecting the public debt of India, or the customs duties or any other tax or duty for the time in force and imposed by the authority of the Governor-General in Council for the general purposes of the Government of India'. A proposal for provincial taxation required the sanction of the Government of India, the approval of the Secretary of State, and the assent of the Finance Department before it could be considered by the Provincial Government. The main argument in defence of the then existing system was thus expressed in the Reforms Report (1919). 'If many buckets are dipping into one well, and drought cuts short the supply of water, obviously the chief proprietor of the well must take it upon himself to regulate the drawings.'[2] Here again, with the increased measure of independence which followed in the wake of the reforms it was inevitable that the Provinces should be given fresh sources of income to pursue their own development policies.

Lastly, the Provincial Government had no power of borrowing in the open market—a restriction which was accepted 'as almost an axiom of the Indian financial system'.[3] It was rather an anomalous position that while Port Trusts and Corporations

[1] ibid., p. 93. [2] ibid., pp. 93–4. [3] ibid., p. 94.

could raise loans on their securities, the Provincial Governments, on account of the legal fiction that the revenues of India were 'one and indivisible', could not borrow on their own account. This feature of the financial system was also changed with the introduction of the Reforms. To these matters we return in the next chapter.

Conclusions

How far were the principles of efficiency, suitability and adequacy, it may be asked, observed in the financial settlements during this long period, 1833–1919? In answering this question it is well to keep in mind that the provincial financial system was closely bound up with the constitutional machinery of the country. The Indian Mutiny marks the beginning of a new era in Indian constitutional and economic life. Before the Mutiny, the East India Company was engaged in conquering and consolidating the British Empire in India. The need for centralization, for political and military reasons, during this period, was therefore paramount. The principles of public finance could not therefore be given full scope in the machinery of provincial finance. All that the Company was interested in was to administer the conquered territories with as great efficiency as possible. Financial problems were subordinate to military and political problems.

With the passing of the Company to the Crown new economic and financial problems arose. During the later half of the nineteenth century the road system was vastly improved and extended and the railway construction was planned and developed in a systematic way so as to serve the whole of India. The general economic development of the country resulted in an excessive financial burden on the state. (At first there was no apparent chance of earning immediate profits from the railways or other works of the Public Works Department.) Hence there was a regular and heavy annual deficit which made it clear that it was urgent to reform the provincial financial system. That the principles of efficiency, suitability, and adequacy could not be fully introduced was due to the fact that the entire responsibility for the raising and spending of provincial revenues could not be entrusted to

Provincial Governments. (Before 1919 legally all the revenues of the Provincial Governments belonged to the Government of India.)

However, beginning with a highly centralized system of finance, each step in the financial decentralization was marked by an effort to enlarge the powers and responsibilities of the Provincial Governments in financial administration. The history of financial devolution in India points to one unmistakable conclusion, namely, that in a continent like India, administration, whether political or financial, in the interest of efficiency needs to be decentralized.[1] With the small beginning of budgets by 'assignments' for a few departmental heads, we passed through the system of budgets by 'assigned' revenues, 'quasi-permanent settlements' and ultimately 'permanent settlements'. At each stage a further step in financial decentralization arose out of the need to secure efficiency, economy and responsibility. Opinions may differ as to the length of the period for which each particular system lasted, but it can hardly be challenged by any critic that each step was an essential inevitable stage in the financial devolution of the country. Moreover, it is worth remembering that though high hopes were entertained at each stage, nobody ever pretended that the system had reached the final stage.[2] Financial devolution has *pari passu* followed the constitutional development of the country. The extent of the transformation can best be realized by the fact that while before 1870 the Governor of Bengal could make 'no alteration in the allowances of public servants . . . establish a new school or augment the pay of a *daroga* (a police officer) to the extent of a rupee',[3] in

[1] See ch. i, pp. 21-2.

[2] Even Lord Curzon, who always entertained very high hopes from his arrangements, on the occasion of the budget debate in the Imperial Legislative Council (1904) used the following guarded language on the financial settlement of 1904: 'These new settlements constitute, in my view, the most important step in the nature of decentralization that has been adopted for many years, and will, I hope, be the forerunner of others in the future.' See *Proceedings of the Governor-General's Legislative Council*, March 30, 1904, p. 547. (India Office Library.)

[3] *The Calcutta Review*, Vol. III, 1845, p. 170. Unfortunately the writer's name is not mentioned.

1919 the same authority could spend crores of rupees without previous reference to the Government of India.

The object of the next chapter is to examine the changes brought about by the Reforms of 1919.

III

THE MONTAGU-CHELMSFORD REFORMS

§1. *THE CONSTITUTIONAL BASIS*

The Introduction of Limited Responsible Government

The announcement of August 20, 1917, by Mr Montagu, the Secretary of State for India, declared that the policy of His Majesty's Government was that of increasing association of Indians in every branch of administration and the gradual development of self-governing institutions with a view to the progressive realization of responsible government in India as an integral part of the British Empire.[1] In consonance with this view Mr Montagu visited India in November, 1917, and the Montagu-Chelmsford Report on Constitutional Reforms was issued on April 22, 1918.[2] After a most elaborate examination of the Report by the Joint Select Committee of the two Houses of Parliament which sat on the Reforms Bill, the Government of India Act, 1919, was passed.

The Reforms mark the end of one epoch and the beginning of a new one. Before the Reforms India was ruled by an absolute system of Government; the Provincial Governments being subordinate to the Central Government in executive, financial and legislative spheres, whilst the Central Government itself was under the control of the Secretary of State for India in these matters. Besides this, the Provincial Governments were not responsible to the Provincial Legislatures. No really responsible Government in the Provinces could be introduced without completely changing these relations. Thus, the first thing which the authors of the Reforms aimed at was to curtail the powers of the Government of India over Provincial Governments in legislative, financial and administrative matters. The authors of the Joint Report well observed:

[1] *Report on Indian Constitutional Reform*, Cmd. 9109 (1918), p. 5.

[2] Cmd. 9109.

> We have to demolish the existing structure, at least in part, before we could build the new. Our business is one of devolution, of drawing lines of demarcation, of cutting long-standing ties. The Government of India must give and the Provinces must receive; for only so can the growing organism of self-government draw air into its lungs and live.[1]

'Central' and 'Provincial' Subjects, 'Reserved' and 'Transferred' Subjects

The Reforms introduced limited responsible government in the Provinces. It classified subjects into 'central' and 'provincial'. Among the important central subjects were military matters, foreign affairs, tariffs and customs, railways, posts and telegraphs, income-tax, currency, coinage and public debt, commerce and shipping and civil and criminal law.[2]

To introduce a measure of limited responsibility, provincial subjects were classified as 'reserved' and 'transferred'. The reserved subjects included land revenue, police, prisons, factory inspection, labour matters in general and administration of justice. In the transferred subjects were placed local self-government, education, sanitation, public health, hospitals, asylums, public works, development of industries, agriculture, veterinary questions and co-operative societies. Broadly speaking, the administration of justice, law and order, and the preservation of financial stability were reserved subjects, and what are loosely called the 'nation-building' departments were transferred.

The Administration of Transferred and Reserved Subjects

The administration of the transferred subjects was placed under the charge of ministers chosen by the Governor from among the elected members of the Provincial Legislative Council. The ministers, together with the Governor, administered these

[1] Cmd. 9109 (1918), p. 101.

[2] The actual division of subjects was carried out by the *Devolution Rules* made under section 45A of the Government of India Act, 1919. The Devolution Rules delimited the provincial field in legislative, administrative and financial matters. The Rules were issued as Cmd. 891 of 1920.

subjects. Under the Act[1] the Governor was to be guided in relation to these subjects by the advice of his ministers unless he thought that their policy would adversely affect the interests of race, religion, education and other subjects. In such cases he could disregard their advice, and if the ministers did not act according to his advice he could himself assume charge of the subject.[2] He could also sanction any expenditure necessary for any department or for the maintenance of the peace and tranquillity of the Province.[3]

The position of the Governor *vis-à-vis* ministers was subject to severe criticism by both the ministers and the Councils.[4] Thus it was said that the ministers had no real power and were constantly over-ruled by the Governor. Indeed, it was said the Governor ran the transferred departments as well as the reserved departments. On the other hand there is evidence that the Governor's relations with his ministers were harmonious. 'We have it on record that in one Province the Governor's power of over-ruling the ministers was never used at all; in another a minister asserted that during the eight years he was minister, there had not been a single occasion when he had been over-ruled by the Governor.'[5]

Perhaps both these views are extreme views. Appadorai is correct that 'the Governor's experience, and the prestige attaching to his position often enabled him to deflect the course of administration and to have a real voice in the affairs of the transferred half. He maintained a central position not always merely as arbiter or reviser, but as the final repository of administrative experience.'[6] If we accept dyarchy as a transitional stage to full responsible government, the position of the Governor *vis-à-vis* ministers, is, I think, the logical outcome of such an arrangement.

The reserved subjects were administered by the Governor and his Executive Council. The Governor normally presided over the meetings of the Executive Council and in case of a

[1] Section 52 (1) and (2).

[2] The defects of dyarchy are discussed in ch. iv.

[3] The question of 'joint' and 'separate' purse is discussed in ch. vi.

[4] See APPADORAI, A., *Dyarchy in Practice* (Longmans) 1937, ch. viii.

[5] ibid., p. 233. [6] ibid., p. 235.

difference of opinion the decision of the majority prevailed, subject to the qualification of the provision under section 50 (2).

The position of the ministers was that they were members of the Executive Government but not of the Executive Council. They held office not at the will of the Council but during the Governor's pleasure. The Legislature, however, could censure their administration, reduce their salaries and refuse supplies.[1] The ministers had then to satisfy two masters, the Legislature and the Governor, and in some cases could not satisfy either of them.

The Principle of Joint Responsibility

Within the limits of transferred subjects the principle of joint ministerial responsibility was the intention of the Joint Report. The principle however was nowhere mentioned in the body of the Act. Yet in the working of the Provincial Councils the principle was recognized by the ministers in Madras, the United Provinces and Bengal. It was largely dependent upon the personal equation of the ministers.[2]

This system of government in the Provinces was popularly called Dyarchy.[3]

Local Self-Government

Besides these changes in the administration of the Provincial Governments, the Reforms laid emphasis on the development of local self-government.[4] After reviewing the history of

[1] In the Central Provinces in 1924–5, the ministers' salaries were fixed at the farcical figure of Rs. 2 per annum. The Swarajist majority also refused all the supplies which lay in its power to vote. See *The Moral and Material Progress of India* (Government Press, Delhi) 1924–5, p. 304.

[2] See ch. iv for joint responsibility. In ch. vi the principle of joint responsibility and its relation with the position of the Finance Member is discussed.

[3] In Bengal in August, 1927, the Provincial Council passed a vote of no-confidence against Mr (now Sir) A. K. Ghaznavi. Mr Chakravarti on the principle of joint responsibility resigned as well. The Bengal Council refused to recognize the principle of joint responsibility and passed a separate resolution of non-confidence against Mr Chakravarti in spite of his assurance that he would resign on account of the non-confidence motion against Mr Ghaznavi.

[4] The problems of local taxation are discussed in ch. xii.

local self-government and the constitution of local bodies as it then existed (1919), the Indian Statutory Commission remarked that outside a few municipalities, there was in India nothing that we should recognize as local self-government of the British type before the era of the Reforms.[1] It is of the highest importance to bear this in mind in appraising the changes introduced by the Reforms.

The authors of the Joint Report in formulating the principles for the realization of responsible government laid down their first formula, that: *There should be, as far as possible, complete popular control in local bodies and the largest possible independence for them of outside control.*[2]

Translating this into practice they suggested an elected majority on all boards, the replacement of official chairmen by elected non-officials on municipalities and, where possible, on district boards. The enlargement of the elected element was to be by the extension of the franchise to make constituencies really representative of the general body of ratepayers. The report in particular laid stress on the advisability of fostering village government by *panchayats*. It recommended that *panchayats* might be endowed with civil and criminal jurisdiction in petty cases, some administrative powers as regards sanitation and education, and permissive powers of imposing a local rate.[3]

Since the Reforms, local self-government both in cities and rural areas, though in some cases it showed signs of deterioration, has made considerable progress. Generally speaking, the functions entrusted to municipalities are the administration of education, public health, sanitation, medical relief and public works, including roads and bridges. Similarly, district boards control rural education, dispensaries, sanitation, country roads, bridges, water-supply, pound, fairs, ferries and *sarais* (rest-houses).[4]

[1] See Cmd. 3568 (1930), p. 302. [2] See Cmd. 9109 (1918), p. 155.

[3] See Cmd. 9109 (1918), p. 161.

[4] In urban areas where troops are stationed the administration is in the hands of cantonments. They are administered by elected Cantonment Boards, the presidents of which are officials (usually military officers). The final control of cantonment administration rests with the Army Department of the Government of India.

Municipalities enjoy a considerable measure of freedom with regard to taxation.[1] Draft rules under section 10 (3) (*a*) of the Government of India Act 1919 empowered the Legislative Council of a Province, without the previous sanction of the Governor-General, to make and take into consideration any law imposing or authorizing any local authority to impose, for local purposes, the following taxes:

(1) A toll.
(2) A tax on land or land values.
(3) A tax on buildings.
(4) A tax on vehicles or boats.
(5) A tax on animals.
(6) A tax on menials and domestic servants.
(7) An octroi.
(8) A terminal tax on goods imported into local areas on which an octroi was levied on or before July 6, 1917.
(9) A tax on trades, professions and callings.
(10) A tax on private markets.
(11) A tax imposed in return for services rendered, such as:
    (*a*) a water rate,
    (*b*) a lighting rate,
    (*c*) a scavenging, sanitary or sewage rate,
    (*d*) a drainage rate,
    (*e*) fees for the use of markets and other public conveniences.[2]

The Government's control in financial matters of local authorities is limited. It can, however, alter their budgets if it considers that they have not made due provision for loan charges, for the maintenance of a working balance or, in other cases, of gross financial negligence. It can also intervene in the administration of local authorities 'by way of preventing or initiating action in matters affecting human life, health, safety or public tranquillity. But these powers have been very infrequently exercised'.[3]

[1] The main sources of income of district boards is a tax or cess on the annual value of land. They also receive grants from the Provincial Governments for particular services. See ch. xii. [2] See Cmd. 891 (1920), pp. 36–7.
[3] See Cmd. 3568 (1930), p. 305.

§2. *THE CHANGES IN THE FINANCIAL SYSTEM*

Abolition of Divided Heads

An essential and important feature in the political development of a country is the extent of growth in the control over the finances by the people. In chapter ii we have seen that one of the defects of the financial system before the Reforms was the absolute control, and interference, of the Central Government in provincial financial matters. It would have been ridiculous to introduce provincial autonomy without separating the resources of the Central and Provincial Governments, because the existing system of divided heads meant joint control and interference from the centre. The authors of the Report rightly observed:

> The present settlements by which the Indian and Provincial Governments share the proceeds of certain heads of revenue, are based primarily on the estimated needs of the Provinces, and the Government of India disposes of the surplus. This system necessarily involves control and interference by the Indian Government in provincial matters. An arrangement which on the whole worked successfully between two official Governments would be quite impossible between a popular and an official Government.[1]

It was highly important that such troubles should be avoided and the best way to do it was to give the Provinces separate resources. Hence as a preliminary to constitutional reforms the authors of the Report proposed the separation of central and provincial finances. It was justly remarked in the Report that if provincial autonomy was to mean anything real, the Provinces must not be dependent on the Indian Government for the means of provincial development.[2]

[1] Cmd. 9109 (1918), p. 104.

[2] The authors remarked: 'Our first aim has therefore been to find some means of entirely separating the sources of the Central and Provincial Governments.' Cmd. 9109 (1918), p. 164.

The separation, however, was *not* complete, because the Provinces had to contribute a portion of their revenues to the Central Government. I think it hardly need be complete. The 'permanent settlements' before the Reforms provided only for the *ordinary* growth of expenditure, but for large and costly

'Imperial' and 'Provincial' Sources of Revenue

To this end, Mr Montagu and Lord Chelmsford proposed to hand over to the Provinces the entire financial responsibility —both in revenue and expenditure—of certain provincial subjects. They abolished the old system of 'divided' heads of revenue. Land, revenue irrigation, excise, forests and judicial stamps, were entirely transferred to the Provinces; while customs, commercial stamps, receipts from railways, salt, opium, posts and telegraphs were to remain wholly central heads of revenue.[1] As a result of this rearrangement the Central Government was faced with a heavy annual deficit of 9·5 crores and the Provincial Governments gained 18·5 crores of additional annual revenue. How to make up this deficit was the chief difficulty of the Committee.

Difficulties in Equitable Provincial Financial Settlements

To remove this deficit the authors of the Report proposed a system of contributions from the Provinces.[2] It was in assessing these contributions that they met with various obstacles on account of the disparity which existed between one Province and another in the extent of their revenue and scales of expenditure due to inequalities of treatment in past financial settlements.[3] Apart from such minor difficulties, the unequal economic development of the country was and must always be the most serious handicap in the distribution of resources. India is a huge continent. Some parts of the country are better fitted for industrial advancement on account of the presence of raw materials, sources of power, and of their better geographical position and improved means of transportation and communication. The huge disparity in economic development and financial resources between industrially advanced Provinces like Bombay and Bengal, and agricultural Provinces like the United Provinces and the Punjab, or the backward Provinces of Bihar, Orissa and

programmes the Provincial Governments had to depend on the doles out of the Indian surplus. See ch. ii.

[1] For a complete list see *Indian Year Book* (*Times of India*) 1920, pp. 691 ff.

[2] The power to levy such contributions was laid down in s. 112 of the Government of India Act, 1919.

[3] See ch. ii.

Assam, cannot be corrected by any redistribution of resources even by the most ingenious finance minister.[1] Moreover, the artificial division of the country into various Provinces, due to the haphazard growth of British power in India, places insurmountable difficulties in the way of an equitable financial adjustment between the various Provinces. In a centralized system of financial allocation and administration, the artificial provincial boundaries were of less importance. But when each Provincial Government, as a result of political advancement, is made responsible for its own revenue and expenditure, such maldistribution of areas into artificial self-contained units creates additional problems, which are not capable of easy and simple solutions. There can never be in India an absolute equality of treatment of the Provinces in financial resources and adjustments. The aim of the financier must be to minimize such natural and artificial inequalities of burdens and resources to as large an extent as is possible in the light of broad principles of public finance.[2]

Provincial Contributions

The authors of the Report were presented with many a plan for removing the central deficit and minimizing inequalities of provincial financial burdens and resources.[3] Their ultimate choice fell upon a system of contributions from each

[1] See ch. i. [2] See ch. i, pp. 8–9 and Appendix I.

[3] The various alternative proposals examined by the authors were as follows: 'One way of meeting it would be to maintain the basis of the present settlements, but to allot to the Government of India a certain proportion of growing revenue instead of its share of the divided heads. But this device would stereotype all the existing inequalities between the Provinces which by reason of the permanent settlement in some of them are considerable while it would also introduce an element of great uncertainty into the Indian Government's finance. A second was that we should take an all-round contribution on a *per capita* basis. But this expedient also would not obviate very undesirable variations between Provinces in the rate of levy owing to the inequality of provincial resources and of provincial needs. A third plan was to take an all-round percentage contribution based on gross provincial revenue. This is open, *inter alia*, to the objection that it would leave several of the Provinces with large deficits. Fourthly, we considered but rejected the proposal that Provinces which had a surplus should temporarily help others as being cumbrous and impracticable.' Cmd. 9109 (1918), p. 168.

Province based on 'a percentage of the difference between the gross provincial revenue and the gross provincial expenditure'[1] that each Province would enjoy under the new allocation of resources. On the basis of the budget figures for 1917–18 (subject to some adjustments) the deficit in the Government of India budget was estimated to be Rs. 13,63 lakhs. The estimated gross provincial surplus (after deducting normal expenditure of all Provinces) was Rs. 15,64 lakhs.[2] This left a net surplus of Rs. 2,01 lakhs available for provincial distribution.[3] Accordingly, each Provincial Government, it was proposed, should contribute 87 per cent of the difference between the gross provincial revenue and the gross provincial expenditure. The provincial contributions and the net provincial surpluses, according to the above principle, are given in the following table:[4]

Province	Gross provincial revenue	Gross provincial expenditure	Gross provincial surplus	Contribution (87 per cent of col. 4)	Net provincial surplus
	In lakhs of rupees				
Madras	13,31	8,40	4,91	4,28	63
Bombay	10,01	9,00	1,01	88	13
Bengal	7,54	6,75	79	69	10
United Provinces ...	11,22	7,47	3,75	3,27	48
Punjab	8,64	6,14	2,50	2,18	32
Burma	7,69	6,08	1,61	1,40	21
Bihar and Orissa ...	4,04	3,59	45	39	6
Central Provinces ...	4,12	3,71	41	36	5
Assam	1,71	1,50	21	18	3
Total ...	68,28	52.64	15,64	13,63	2,01

The authors of the Report, however, admitted the inequality of the burdens and recommended that after ten years' experience

[1] Cmd. 9109 (1918), p. 169.

[2] The estimated provincial expenditure included provision for famine relief and protective irrigation. Both of these heads were transferred to the Provincial Governments.

[3] i.e. 13 per cent of the gross available surplus.

[4] See Cmd. 9109 (1918), p. 169.

of the working of the system the whole question of provincial contributions should be reinvestigated by the Statutory Commission proposed by them.[1]

Criticism of the Basis of the Provincial Contributions

These proposals were severely criticized by the Provincial Governments. The method of assessing the provincial contributions was regarded as highly unfair. The *prima facie* injustice of the scheme can be seen at a glance from the percentages which the contributions would have borne to the net provincial revenues.[2]

Madras	... 47·7 per cent
United Provinces ...	... 41·1 per cent
Bengal	... 10·1 per cent
Bombay	... 9·6 per cent

This would have meant that the richest as also the most economical Province would have paid the most while the most extravagant Province would have paid the least. It would have penalized thrift and encouraged extravagance. In other words, it was really equivalent to putting a premium on extravagance and inefficiency.

The inequality of the treatment seemed to be so apparent that the Government of India in their dispatch of March 5, 1919, pressed for an early treatment of the matter. They proposed the appointment of a committee to advise on financial relations between the Central and Provincial Governments. This recommendation of the Government of India was accepted by the Joint Select Committee of the Houses of Parliament, and the Financial Relations Committee with Lord Meston as its Chairman was appointed in January, 1920.[3]

[1] The weighty words of the authors have not received due consideration at the hands of their critics. The authors fully realized the limitations of their proposals when they wrote: 'We have, for the present, *accepted the inequality of burden* which history imposes on the Provinces because we cannot break violently with traditional standards of expenditure, or subject the permanently-settled Provinces to financial pressure which would have the practical result of forcing them to reconsider the permanent settlement.' Cmd. 9109 (1918), pp. 170, 171. (The italics are mine.)

[2] i.e. gross provincial revenue *minus* provincial contribution.

[3] Cmd. 724 (1920).

The Meston Committee

The allocation and distribution of financial resources between the Central Government and the Provincial Governments between 1921–2 and 1936–7, were primarily based on the recommendations of the Meston Committee.[1] A careful study of the Report is extremely important in view of the new basis which the Committee adopted for fixing the provincial contributions. These contributions, popularly known as the 'Meston Award', were largely responsible for the financial stringency in the early years of the working of the Reformed Councils.

The Committee did not favour the distribution of the income-tax proceeds among the Provinces for the two strong reasons advanced in the Joint Report—first, the necessity of maintaining a uniform rate throughout the country, and secondly, the difficulty of finding out the exact locale of the tax, as in the case of ramifying enterprises the Province where the tax was paid was not necessarily the Province where the tax was earned.

The authors of the Joint Report had divided stamps into two classes—General Stamps and Judicial Stamps: the former they had allocated to the Central Government, the latter to the Provincial Governments. The Meston Committee, in order to help the poorer Provinces, recommended that General Stamps should be provincialized. This, they thought, would also remove the last 'taint of a divided head'. Moreover, such an arrangement would facilitate the control and collection by the same agency.

The Meston Award

As a result of the above recommendations for the allocation of the heads of revenue and expenditure between the Central

[1] The Meston Committee was to advise on:

(i) The contributions to be paid by the various Provinces to the Central Government for the financial year 1921–2.

(ii) The modifications to be made in the provincial contributions thereafter with a view to their equitable distribution until there ceases to be an all-India deficit.

(iii) The future financing of the provincial loan account.

(iv) Whether the Government of Bombay should retain any share of the revenue derived from income-tax.

Cmd. 724 (1920), par. 3.

and Provincial Governments, the Committee estimated a deficit of 9·83 crores in the Central budget for the year 1921–2.[1] The actual distribution of the deficit among the Provinces presented various difficulties to the Committee. The Committee found that the scheme of contributions proposed in the Joint Report, namely assessment proportionate to the gross surplus, was unfair and they accordingly dropped it. The authors of the Joint Report had considered *both revenue and expenditure* in fixing the contributions. Herein lay the main difficulty. While the normal revenue figures, arrived at at the Simla conference, on the basis of which the contributions were fixed, were generally accepted by the Provinces, the estimates of normal expenditure were strongly contested. The Committee were faced with certain contentious questions like these: 'How much of the expenditure held over during the war, or clearly imminent if not already sanctioned, ought to be included in the calculation of normal expenditure? Where is the dividing line to be drawn between expenditure essential in the immediate future, and expenditure foreseen as a future commitment? Ought a Province to be penalized by an increase of its contribution for strict adhesion to economy during the war, while another Province, which had increased its expenditure more freely, is rewarded by a reduced contribution? Is adequate allowance made for the special conditions of a largely undeveloped Province like Burma,

[1] (i) Six crores was the deficit previously estimated by the Government of India; to this four crores was added for the loss of General Stamps.

(ii) In arriving at the above figure two important adjustments were made:

(*a*) The Burma Government had represented that as 68 per cent expenditure on military police in the Province was incurred for frontier defence, the amount ought to be debited to the central budget. The Committee accepted this view and recommended that Rs. 17·42 lakhs only should be charged to the Province on this account.

(*b*) The main adjustments, however, were concerned with the payment of pensions. Before the Reforms all civil pensions paid outside India were debited to the Central Government whether the pensioner had served in the Imperial Department or in the Provinces. The Provincial Governments were not charged for such pensions. The Committee recommended that henceforward all pensions paid outside India should be debited to the Province where the pensioner had served. Similarly, the Government of India should pay its own pensioners. Cmd. 724 (1920), par. 10.

or for the circumstances of a recently established Province like Bihar and Orissa, which claims that it has never received from its start resources adequate to its needs?'[1] To these questions the Committee could find no satisfactory answers.

Initial Contributions

The Committee, in fixing the initial contribution, made an important departure from the principle laid down by the Joint Report. They dropped altogether the considerations of *expenditure* in fixing the contributions. They fixed the contributions on a new principle, namely that of *the increased spending power of each Province under the new allocation of resources.* The Committee, however, in applying this principle placed before it two broad considerations:

(i) That each Province must be left with a certain reasonable working surplus.

(ii) That in no case should the contribution be such as to force the Province to embark on new taxation *ad hoc.*[2]

In view of the above two limiting considerations the initial contributions were in some measure arbitrarily dictated by the existing financial position of each Province and not by an equitable standard such as capacity to pay.[3] Hence the Committee considered the case of each Province on its merits and recommended the following assessments, which were accepted by the Joint Select Committee:[4]

[1] See Cmd. 724 (1920), par. 13. [2] ibid., par. 11.

[3] 'In making our recommendations as to the initial contributions we have had to consider established programmes of taxation and expenditure, and legislative and administrative expectations and habits, that cannot without serious mischief be suddenly adjusted to a new and more equitable ratio of contribution widely different (as an equitable ratio must admittedly be) from that of the past. It is accordingly inevitable, if such mischief is to be avoided, that the ratio for initial contributions should bear little relation to that which would be ideally equitable. But an initial ratio of this nature can only be defended as a measure of transition.' ibid., par. 23.

[4] In fixing these contributions, Burma, Bihar and Orissa, the Central Provinces and Assam received special consideration. Burma was lightly assessed on account of its backward condition. No contribution was recorded for Bihar and Orissa for 1921–2 as the Province was the poorest in India in its revenue resources. The Central Provinces and Assam were assessed at 40 per cent because they had a small margin. Bombay, Bengal, the United

INITIAL CONTRIBUTIONS (IN LAKHS OF RUPEES)[1]

PROVINCES	INCREASED SPENDING POWER UNDER NEW DISTRIBUTION OF REVENUE	CONTRIBUTIONS RECOMMENDED BY THE COMMITTEE	INCREASED SPENDING POWER LEFT AFTER CONTRIBUTIONS ARE PAID
Madras	5,76	3,48	2,28
Bombay	93	56	37
Bengal	1,04	63	41
United Provinces ...	3,97	2,40	1,57
Punjab	2,89	1,75	1,14
Burma	2,46	64	1,82
Bihar and Orissa ...	51	nil	51
Central Provinces ...	52	22	30
Assam	42	15	27
Total ...	18,50	9,83	8,67

Standard Contributions

These *initial* contributions, which were only transitional, were not considered by the Committee as ideally equitable. In their opinion the standard contributions were to be based on a more satisfactory, equitable and certain basis. They observed that 'to do equity between the Provinces it is necessary that the total contribution of each Province to the purse of the Government of India, should be proportionate to its capacity to contribute'.[2]

In translating this principle into practice the Committee were faced with two important considerations. What were the *total* contributions of a Province to the revenues of the Central Government? Secondly, and a more difficult question, What were the capacities of the Provinces to contribute? With regard to the first question the Committee observed that 'the total contribution of a Province to the purse of the Government of India will consist in future of its direct contribution towards

Provinces and Madras were equally treated and were required to pay 60 per cent of their spending power. ibid., pars. 18, 19, 20.

[1] ibid., par. 17.

[2] ibid., par. 24.

the deficit, together with its indirect contribution (as at present) through the channels of customs, income-tax, duties on salt, etc.'[1]

Turning to the second question of an equitable distribution, the Committee stated that 'the capacity of a Province to contribute is its taxable capacity, which is the sum of the income of the taxpayers or the average income of its taxpayers multiplied by their number'.[2]

An evaluation of the amounts of indirect contributions attributable to each Province involves an exact arithmetical calculation for which adequate statistical information was not available. Moreover, such information as was available could not be of much use for, e.g., under the head of customs the locality in which the revenue was collected was, surely, not the locality where the articles were consumed. Similarly, under income-tax, questions of the utmost complexity arise, such as the fact that the place where the tax is collected is not the true source of the origin.[3] The Committee rightly did not place too much reliance on these factors and in fixing the standard contributions gave due weight to 'the more general circumstances of the economic life of the Provinces'.

The Committee therefore applied the concept of taxable capacity by fixing the contributions with great caution. I cannot do better than quote at length the view of the Committee in this matter. They observed that:

> We are able, after surveying such figures as are available and after close inquiry into the circumstances of each Province, to recommend a fixed ratio of contributions which in our opinion represents a standard equitable distribution of the burden of any deficit. In arriving at this ratio we

[1] ibid., par. 25. The Committee here were considering the claims of industrial Provinces like Bombay and Bengal which contributed the largest share to the central revenues through customs and income-tax. This question is discussed in ch. iv.

[2] ibid., par. 26. In fixing the second principle the Committee had in mind the claims of poorer Provinces like Assam, Bihar and Orissa, whose resources had not fully developed and whose capacity to pay was small.

[3] The fallacy of such argument, on which the industrial Provinces of Bombay and Bengal base their claims for favoured treatment, is discussed on p. 102.

have taken into consideration the indirect contributions of the Provinces to the purse of the Government of India, and in particular the incidence of customs duties and of income-tax. We have inquired into the relative taxable capacities of the Provinces, in the light of their agricultural and industrial wealth and of all other relevant incidents of their economic positions, including particularly their liability to famine. It should be observed that we have considered their taxable capacities not only as they are at the present time, or as they will be in the immediate future, but from the point of view also of the capacity of each Province for expansion and development agriculturally and industrially, and in respect of imperfectly developed assets such as minerals and forests. We have also given consideration to the elasticity of the existing heads of revenue which will be secured to each Province, and to the availability of its wealth for taxation.[1]

After estimating, to the best of their ability, the weight which should be given to each of the circumstances mentioned above, the Committee recommended the following fixed ratio of standard contribution which each Province should pay to meet the deficit in the budget of the Government of India:

STANDARD CONTRIBUTIONS[2]

Provinces	Per cent contribution to deficit
Madras	17
Bombay	13
Bengal	19
United Provinces	18
Punjab	9
Burma	6½
Bihar and Orissa	10
Central Provinces	5
Assam	2½
	100

[1] Cmd. 724 (1920), par. 27. I have quoted at length the views of the Committee to prove later on that the principles on which the 'award' was based were not unsound. It was the *political machinery* and the *economic conditions* of the times which condemned them. See ch. iv, pp. 85 and 87.

[2] Cmd. 724 (1920), par. 27.

The Committee, in order to avoid sudden dislocation in provincial budgets, further safeguarded their findings by requiring an interval of seven years to enable the Provinces to adjust their budgets to new conditions. The initial, intermediate and ultimate ratios of contributions as recommended by the Committee are given in the following table:[1]

Provinces	1st Year	2nd Year	3rd Year	4th Year	5th Year	6th Year	7th Year
Madras	35½	32½	29½	26½	23	20	17
Bombay	5½	7	8	9½	10½	12	13
Bengal	6½	8½	10½	12½	15	17	19
United Provinces...	24½	23½	22½	21	20	19	18
Punjab	18	16½	15	13½	12	10½	9
Burma	6½	6½	6½	6½	6½	6½	6½
Bihar and Orissa ...	nil	1½	3	5	7	8½	10
Central Provinces	2	2½	3	3½	4	4½	5
Assam	1½	1½	2	2	2	2	2½
Total ...	100%	100%	100%	100%	100%	100%	100%

Changes made by the Devolution Rules

These recommendations of the Committee were severely criticized by the public and the Provincial Governments, whose views were invited by the Government of India.[2] The Secretary of State and the Government of India, however, accepted them. The Joint Select Committee of Parliament, in view of the loud protests of the Provincial Governments, made some changes in revising the Draft Rules made under the Government of India Act 1919.[3] Accordingly the Devolution Rules provided:

> (15) There shall be allocated to each Local Government a share in the income-tax collected under the Indian Income Tax Act, 1918, within its jurisdiction. The share so

[1] ibid., par. 28.

[2] The views of the Government of India and the Local Governments are published in Cmd. 974 (1920).

[3] Section 45 A, Cmd. 891 (1920).

allocated shall be three pies on each rupee brought under assessment under the said Act, in respect of which the income-tax assessed has been collected. The number of pies to be specified shall be so calculated as to yield at the outset to the Local Governments collectively a sum amounting as near as may be to 400 lakhs.

(17) In the financial year 1921–2 contributions shall be paid to the Governor-General in Council by the Local Governments mentioned below according to the following scale:

Name of Province	Contributions (in lakhs of rupees)
Madras	3,48
Bombay	56
Bengal	63
United Provinces	2,40
Punjab	1,75
Burma	64
Central Provinces and Berar ...	22
Assam	15

(18) From the financial year 1922–3 onwards a total contribution of 9,83 lakhs, or such smaller sum as may be determined by the Governor-General in Council, shall be paid to the Governor-General in Council by the Local Governments mentioned in the preceding rule. When for any year the Governor-General in Council determines a smaller sum than that payable for the preceding year, a reduction shall be made in the contributions of those Local Governments only whose last previous annual contribution exceeds the proportion specified below of the smaller sum so determined as the total contribution; and any reduction so made shall be proportionate to such excess:

Madras	17/90ths
Bombay	13/90ths
Bengal	19/90ths
United Provinces	19/90ths
Punjab	9/90ths
Burma	6½/90ths
Central Provinces and Berar ...	5/90ths
Assam	2½/90ths

Provincial Loan Account

A few more changes, introduced by the Reforms, to complete the separation between the provincial and central finances, need our attention at this stage. First, it was commonly agreed that the Provincial Loan Account should be closed and the Provinces should in future finance their own loan transanctions.[1] On the basis of the recommendations of the Financial Relations Committee it was provided by Rule 23 of the Devolution Rules that:

> Any moneys which, on the 1st day of April, 1921, are owed to the Governor-General in Council on account of advances made from the Provincial Loan Account of any Province shall be treated as an advance to the Local Government from the revenues of India, and shall carry interest at a rate calculated on the average rate carried by the total amount owed to the Governor-General in Council on this account on the 31st March, 1921. The interest shall be payable upon such dates as the Governor-General in Council may fix. In addition, the Local Government shall pay to the Governor-General in Council in each year an instalment of the principal amount of the advance, and this instalment shall be so fixed that the total advance shall, except where for special reasons the Governor-General in Council may otherwise direct, be repaid before the expiry of twelve years. It shall be open to any Local Government to repay in any year an amount in excess to the fixed instalment.[2]

Irrigation under the Reforms

Irrigation,[3] under the Reforms scheme, was a provincial reserved subject. It would have been incompatible, under the scheme, to make the Government of India responsible for such expenditure and to hand over the control to the Provincial Governments. Hence Devolution Rule 24 provided that:[4]

> (1) The capital sums spent by the Governor-General in Council upon the construction in the various Provinces

[1] Cmd. 724 (1920) ch. vi, Provincial Loan Account.
[2] Cmd. 891 (1920). [3] See ch. viii. [4] Cmd. 891 (1920).

of productive and protective irrigation works and of such other works financed from loan funds as may from time to time be handed over to the management of Local Governments shall be treated as advances made to the Local Governments from the revenues of India. Such advances shall carry interest at the following rates, namely:

(*a*) In the case of outlay up to the end of the financial year 1916–17, at the rate of 3·3252 per centum.

(*b*) In the case of outlay incurred after the financial year 1916–17, at the average rate of interest paid by the Governor-General in Council on loans raised in the open market since the end of that year.

(2) The interest shall be payable upon such dates as the Governor-General in Council may fix.

Provincial Borrowings[1]

Prior to the Reforms, as we have already noticed, the power of borrowing was not conceded to the Provinces. The authors of the Reforms clearly recognized that if Provincial Governments were to enjoy such a real measure of independence as would enable them to pursue their own development policy, they must be given some powers of raising loans on the security of their resources. Consequently the Local Government Borrowing Rules, made under the Government of India Act, provided that, subject to certain conditions:[2]

A Local Government may raise loans on the security of the revenues allocated to it for any of the following purposes, namely:

(*a*) To meet capital expenditure on the construction or acquisition (including the acquisition of land, maintenance during construction and equipment) of any work or permanent asset of a material character in connexion with a project of lasting public utility, provided that:

(i) the proposed expenditure is so large that it cannot reasonably be met from current revenues, and

[1] See ch. ii, pp. 54–5.

[2] See Cmd. 891 (1920).

(ii) if the project appears to the Governor-General in Council unlikely to yield a return of not less than such percentage as he may from time to time by order prescribe, arrangements are made for the amortization of the debt;

(*b*) to meet any classes of expenditure on irrigation which have under the rules in force before the passing of the Act been met from loan funds;

(*c*) for the giving of relief and the establishment and maintenance of relief works in times of famine or scarcity;

(*d*) for the financing of the Provincial Loan Account; and

(*e*) for the repayment or consolidation of loans raised in accordance with these rules or the repayment of advances made by the Governor-General in Council[1] (Section 2).

'*Scheduled Taxes*'

The authors of the Report clearly saw that for the growth of real provincial autonomy the Provincial Governments must be allowed to impose taxes without the previous sanction of the Government of India. Hence by the rules made under the Reforms Act it was provided that: [2]

> The Legislative Council of a Province may, without the previous sanction of the Governor-General, make and take into consideration, any law for imposing for the purpose of the Local Government any tax included in Schedule I.[3]

[1] These rules were subject to the following two conditions: (1) No loan shall be raised by a Local Government without the sanction (in the case of loans to be raised in India) of the Governor-General in Council, or (in the case of loans to be raised outside India) of the Secretary of State in Council, and in sanctioning the raising of a loan the Governor-General in Council or the Secretary of State in Council, as the case may be, may specify the amount of the issue and any or all of the conditions under which the loan shall be raised. (2) Every application for the sanction of the Secretary of State . . . shall be transmitted through the Governor-General in Council. Cmd. 891 (1920), section 3.

[2] Rules under s. 10 (3), (*a*) of the Government of India Act, 1919, Scheduled Taxes Rules. Cmd. 891 (1920). See also ch. ix.

[3] Section 2.

This schedule comprised the following heads of taxation:

(1) A tax on land put to uses other than agricultural.
(2) A tax on succession or acquisition by survivorship in a joint family.
(3) A tax on any form of betting or gambling permitted by law.
(4) A tax on advertisements.
(5) A tax on amusements.
(6) A tax on any specified luxury.
(7) A registration fee.
(8) A stamp-duty other than duties of which the amount is fixed by Indian legislation (Schedule I).[1]

In other cases the previous sanction of the Governor-General in Council was necessary.

Provincial Budgets

Finally, as a result of the proposed separation of revenues a complete separation of the central and provincial budgets came in. Before the Reforms the budget of the Government of India included the transactions of all the Provincial Governments as well. Henceforward, the provincial budget instead of being passed by the Finance Department of the Government of India, was framed by the Finance Department of each Province.

Thus was cut the financial, administrative and legislative strand which had so far blocked the path for the growth of provincial autonomy in India.

Conclusion

The Reforms mark the end of the old era and the beginning of a new one. With the introduction of limited provincial autonomy the Central Government's legislative, administrative and financial control in provincial matters decreased considerably. The Provincial Governments were given real freedom to work the Reforms in a limited sphere. The transfer of financial control was perhaps the greatest line of advancement. Nevertheless, the Reforms were regarded as a niggardly gift and a sham. The critics 'termed them a dress giving only the

[1] Cmd. 891 (1920).

trappings of reality to a dead body which had neither life nor force'.[1]

This, however, is an extremely shallow view of the Reforms. Every student of Indian problems, whatever his prepossessions, must be driven by the inexorable force of facts to recognize that the Reforms were a transitional stage in the constitutional evolution of the country. From the Reforms did emerge a steady, though slow, process of administrative devolution from the Government of India to the Provincial Governments, which has profoundly affected the whole course of India's future constitution. This gradual devolution produced three important results. 'It had tended to remove provincial administration from the immediate purview of His Majesty's Government and, by thus weakening the direct accountability of Indian administrators to Parliament, it had, perhaps, rendered inevitable the introduction, in some degree, of local responsible government. At the same time, it had tended to make the Provinces the centres of the development of social services; and it had also tended to transfer to the Provincial Executives the prime responsibility for the preservation of law and order.'[2] It is these changes which led to the abolition of dyarchy and to the introduction of provincial autonomy in 1937.

[1] Speech of Lord Reading to the Joint Session of Indian Legislatures, July 28, 1923.

[2] See *Joint Committee on Indian Constitutional Reforms* (1933–4), Vol. I, Part I, p. 9.

IV

THE MESTON SETTLEMENT AND ITS RESULTS

The division of public revenues among the different Provincial Governments covering a very wide geographical area is an extremely difficult problem in India. Under the highly centralized system of administration before the Reforms the division of financial responsibilities was comparatively simple. But with the introduction of responsible government the equitable distribution of burdens and resources was no longer an easy matter. The same forces which promoted decentralization of governmental functions demanded decentralization of tax administration. The task of the Meston Committee was highly difficult. For a proper understanding of the working of the Meston Settlement it is essential that we take into consideration the defects of dyarchy as well as the unforeseen economic circumstances under which the system was introduced. Hence we may divide the issues into three parts:

(i) The working of dyarchy and its financial effects.

(ii) The unforeseen economic circumstances and their effects on the working of the Meston Settlement.

(iii) An examination of the principles of the allocation of revenue and expenditure between the Central and Provincial Governments and between the Provinces *inter se*.

§1. *THE WORKING OF DYARCHY*

The Administration of Reserved and Transferred Subjects

The outstanding feature of government in the Provinces under dyarchy was the division of the administration into two distinct spheres—the 'transferred' and the 'reserved' halves of the Government. The theory of the dyarchic constitution was to make the ministers jointly responsible to the elected legislature in respect of the transferred half of the Government. But in the

actual working of the constitution it became impossible to translate this theory into practice.[1] In their evidence before the Reforms Enquiry Committee the majority of the ex-ministers pointed out that they were dealt with by their Governors individually and not collectively. In other words, 'there were ministers but no ministries'. The growth of the principle of joint responsibility was largely dependent upon the personal equation of the ministers.[2]

The unhappy political circumstances under which the Reforms were started made it impossible for the ministers to secure an elected majority. The ministers were largely dependent on the support of the official bloc and were generally regarded as 'Government men'. Their policy was considerably influenced by the reserved side of the Government with the result that the ties between the ministers and their supporters weakened.

The failure to establish 'joint responsibility' on the transferred side further resulted in a loss of support and confidence of the provincial legislatures and ultimately impeded the conduct of business.

Again, the Act made no provision for joint deliberation between the two halves of the Government. The actual practice followed differed from Province to Province. In the United Provinces in the beginning 'there were weekly meetings of the whole Government'; such meetings generally became less frequent as time went on. In Madras, joint deliberation between the two halves of the Government was laid down as an essential feature and it exercised a wholesome influence in the working of the constitution.

The absence of joint deliberation gave rise at times to friction and feelings of mutual distrust between the ministers and the executive councillors, which were not conducive to efficient and good administration.

[1] See chs. iii and v.

[2] 'The evidence of Mr Chitnavis and Rao Bahadur Kelkar of the Central Provinces, of Lala Harkishenlal of the Punjab, and of Sir P. C. Mitter of Bengal, shows that not only did the Governors deal with their ministers separately but the latter, in some provinces at any rate, themselves did not observe the convention of joint responsibility.' *Report of the Reforms Enquiry Committee: Minority Report*, p. 154. Cmd. 2360 (1925).

The success in the working of dyarchy was largely due to the dominant influence of Governors in harmoniously combining the interests of the two halves of the Government. The precise extent to which dyarchy succeeded is different from Province to Province. Its success even in the same Province is different from time to time with the personal equation of the Governors.

Joint or Separate Purse[1]

Before the inauguration of the Reforms, the question of the Joint or Separate Purse loomed large in public discussions. There was much discussion as to whether the revenues of a Province should be treated as one single fund out of which funds should be allocated to the two halves of the Government, or whether in view of the dyarchic constitution, the transferred departments should have their own separate funds distinct from the resources available to the reserved departments. The authors of the Reforms proposed that the provincial budget should be framed by the executive Government as a whole. The first charge on provincial revenues was to be the provincial contribution to the Government of India; after that the supply for the reserved subjects was to have priority. Lastly, the allocation of supply for the transferred subjects was to be decided by the ministers, who were, with the Governor, also to decide the question of new taxation, if the revenues were insufficient.

These proposals were criticized by the Government of India on the ground that such a procedure for the allocation of revenues would create friction between the two halves of the Government. Nevertheless, they finally came to the conclusion that it was advisable to divide the revenues between the two halves of the administration and hence they recommended the method of separate purses.

The Joint Select Committee, however, expressed its preference for a 'joint purse', and this arrangement was ultimately adopted in the Devolution Rules. Consequently, in each Governor's Province, under the Reforms, the budget was framed by the Finance Member, who belonged to the reserved half of the administration.

[1] See ch. vi.

It is commonly supposed that this arrangement was a serious difficulty in the working of the Reforms.[1] This, however, was not the cause. The allocation of revenues between the transferred and reserved subjects was decided by an agreement between the ministers and the Finance Member. Dr Gangulee is hardly correct when he says that 'this proved to be a serious handicap to the ministerial position, and in every Province this financial arrangement not only led to considerable friction but to a certain amount of irresponsibility in both the halves of the Government'.[2] The actual difficulty was the financial stringency which did not leave enough surplus funds for the ministers to develop 'nation-building' departments. The system of separate purses would probably have aggravated the difficulties instead of mitigating them.[3]

The Defects of Dyarchy

The defects of the working of dyarchy were brought into relief by the Reforms Enquiry Committee, generally referred to as the Muddiman Committee.[4] Most of the Provincial Governments and ministers who had worked the Constitution condemned the working of the system. 'It was a common cry', said the Bengal Government, 'that the transferred departments were being starved at the expense of the reserved departments. It was no wonder that when, under the reformed system, the popular ministers were unable through lack of money to produce and carry out schemes of development in education, public

[1] See ch. vi for further discussion.

[2] GANGULEE, N., *The Making of Federal India* (Nisbet) 1936, p. 51.

[3] *The Reforms Enquiry Committee* (*Majority* and *Minority*) were both in favour of 'joint purses'. See *Majority Report*, pp. 92–3; *Minority Report*, p. 168: Cmd. 2360 (1925). The Simon Commission also favoured 'joint purse'. See Cmd. 3568 (1930), par. 397.

[4] The Reforms Enquiry Committee, under the chairmanship of Sir Alexander Muddiman, was appointed by the late Mr Ramsay MacDonald. The Committee issued two Reports—a Majority Report and a Minority Report. The report of the committee is instructive as it contains the views of several ex-ministers who had actually worked the Constitution. *Report*, Cmd. 2360 (1925). The views of the Local Governments are given in Cmd. 2361 and 2362 (1925).

health and the like, the system has been condemned in many quarters.'[1]

Dyarchy, in the words of the Governor of the United Provinces, is obviously a cumbrous, complex, confused system, having no logical basis, rooted in compromise, and defensible only as a transitional expedient.[2]

The Minister of Industries in Madras gave his experience of dyarchy in the following words:

'I am minister of development minus forests, and you all know that development depends a good deal on forests.[3] I am minister of industries without factories, which is a reserved subject, and industries without factories are unimaginable. I am a minister of agriculture minus irrigation. You can understand what that means. How agriculture can be carried on extensively without irrigation in the hands of those who are responsible for it is rather hard to realize. I am also minister of industries without electricity, which is also a reserved subject. The subjects of labour and boilers are also reserved.'[4]

From the foregoing account it is clear that the defects of dyarchy, caused partly by political difficulties, such as the lack of co-operation on the part of Swarajists, partly by the absence of joint responsibility and joint deliberation—resulted in an atmosphere of mistrust and suspicion which damped the enthusiasm and energies of the ministers.[5] This reacted on the financial policy, and the Meston Settlement was condemned in unequivocal terms everywhere.

[1] Cmd. 2362 (1925), p. 140. [2] ibid., p. 168.

[3] Forests was a 'reserved' subject except in Bombay where it was 'transferred'. See ch. viii.

[4] Cmd 2362 (1925), p. 109.

[5] The Swarajists pledged themselves to a policy of uniform, continuous and consistent obstruction, with a view to making government, through the Assembly and the Provincial Councils, impossible.

§2. *THE EARLY FINANCIAL DIFFICULTIES IN THE WORKING OF THE MESTON SETTLEMENT*

The Unforeseen Economic Circumstances

A common fallacy in the treatment of the problems of provincial finance in India is to regard the financial problems of the Central and Provincial Governments as entirely separate. Under the Reforms the system of central and provincial finance, though separated as book accounts, was largely interconnected and interdependent. The unsatisfactory position of the Government of India's finances, caused by world-wide trade depression, heavy losses on account of exchange difficulties, lowered railway earnings and the high expenses of the Frontier disturbances, largely aggravated the difficulties of the Provincial Governments in the successful working of the Reforms.

Heavy Central and Provincial Deficits

The Central Government was passing through a period of exceptional financial stress and strain. For five years in succession (1917–22) there was a deficit budget. The accumulated total deficit at the close of 1922–3 was no less than Rs. 100 crores, in spite of the additional heavy taxation. In two years, 1921–3, the Central Government imposed 23 crores of new taxation, apart from increased railway and postal charges. In 1923–4 the Government of India was again faced with a deficit of 4·5 crores which led to the increase of the salt duty to Rs. 2-8 per maund. Out of the total deficit of 100 crores, 31 crores was met by the creation of paper money, which represented nothing but the I.O.U.s of the Government of India. The remaining 69 crores was raised by borrowing and the issue of Treasury Bills.[1]

The Provincial Governments were also passing through a period of financial distress. In March 1922, Lord Hailey put the excess of provincial expenditure over revenue at eight crores of rupees. The result was that most of the Provincial

[1] See the speech of Sir Basil Blackett in introducing the Finance Bill for 1923-4, March 1, 1923.

Governments were living on their balances, which were reduced from sixteen crores in 1921 to only five crores in 1922. Some of the Provinces had exhausted their balances, while others were living on borrowed balances.[1]

The Difficulties in the Early Abolition of Provincial Contributions

The problem was an all-India one. The abolition or reduction of provincial contributions no doubt would have reduced the provincial deficits, but the deficit of the Government of India would have increased. The total quantity of deficit would have been the same—whether we had wholly central or wholly provincial deficits or partly central and partly provincial deficits. The vacuum would have been either at Delhi or in the Provinces.

It was easy to suggest that provincial contributions should cease at once. But the crucial point is what were the alternative methods to restore the budgetary equilibrium of the Central Government? It would have been impossible to cut down the expenditure by say 20 to 30 crores per annum all of a sudden without a serious loss of administrative efficiency. The difficulties of increased taxation were immense. The best evidence of the difficulty of imposing new taxation is furnished by the Legislative Assembly refusing its assent to increase the Salt Duty in 1922 and twice again in 1923, even after the Finance Member had gravely assured the House that it was an emergency measure and the only way to financial solvency.[2] The Legislative Assembly still persisted in refusing its assent

[1] See the speech of Lord Hailey in introducing the Finance Bill for 1922–3, March 1, 1922.

[2] Sir Basil Blackett in his Budget speech, 1923, observed: 'I appeal to the House for one last long and strong pull, all of us pulling together, in the confident assurance that so doing we shall quickly get the boat out of the vicious current which is threatening to drag India down on to the rocks of insolvency. Once back in safe waters, I have every hope that in a surprisingly short time we shall find ourselves on the flood tide of prosperity, and shall be able to turn our minds to pleasant thoughts of reduced provincial contributions, reduced taxation, and increased devotion of our resources to the development of India . . . Let us crown our success by a fourth red-letter day, and end our Session with a balanced budget.' Speech of Sir Basil Blackett in introducing the Finance Bill, March 1, 1923.

and the tax was thereupon certified by the Viceroy. Opinions will always differ as to how far Lord Reading was justified in certifying the Finance Bill in 1923. Perhaps the best criticism of the embarrassing situation is given by Dr Anstey in the following sentences:

'It is difficult to decide how far the very violent opposition to the higher rate of duty was genuine, and how far the incident was utilized as a convenient stick with which to beat the Government at a period when non-co-operation was at its height. It is possible that the burden imposed by raising the tax has been exaggerated, but as the tax undoubtedly does affect the whole population, it ought not to be increased except at a time of urgent financial stress.'[1]

The Meston Settlement was based on the assumption that the deficit of the Central Government at the initiation of the Reforms, to be made good from provincial contributions, would be Rs. 9,83 lakhs. This figure was based upon various assumptions, three of which were of great importance. The first was the two-shilling rate of exchange; the second was a military budget of Rs. 43 crores; and the third was that railways would yield a net profit of Rs. 8 to 10 crores per annum. These optimistic calculations were all falsified. Exchange behaved in a most wayward manner, resulting in a loss of no less than Rs. 15·5 crores. The military budget cost more than 20 crores beyond the assumed figure of 43 crores. The revenue from railways was also disappointing, and the receipts owing to trade conditions fell off seriously. With this new situation it was obviously impossible for the Government of India to make a beginning in the reduction of provincial contributions. The increase of further debts would have been a dangerous and disastrous course.[2] To do so would have increased the uncovered

[1] ANSTEY, V., op. cit., p. 380. See also ch. ix.

[2] 'A large volume of Treasury Bills is an evil in England, where the condition of the money market is such that it is always possible to renew maturing bills by offering a competitive rate, but in India conditions might easily arise under which even an impossibly high rate would be insufficient, and in that case the Government of India would be driven back to replacing the Treasury Bills by paper currency, i.e. would be driven to taxation by inflation.'—Speech of Sir Basil Blackett in introducing the Finance Bill for 1923–4, March 1, 1923.

deficit of the Central Government, which must inevitably have resulted in the financial insolvency and ultimate ruin of the whole country.

Conclusion

To conclude, the situation as explained above was certainly difficult—much more difficult than most people imagine or care to realize. The Meston Settlement received undue condemnation on account of the series of deficits in Central and Provincial budgets which coincided with the inauguration of the Reforms. With the steady revival in trade and increased prosperity the era of unbalanced budgets disappeared. Sir Basil Blackett's six years of financial leadership saw the rehabilitation of the finances of the Central Government and marked the abolition of the much-talked-of provincial contributions. The Government of India made a real and honest attempt to wipe off the provincial contributions as soon as their financial position improved. Hasty measures in the field of finance always lead to the ditch.

Provincial Contributions (1921–7)

The provincial contributions from 1921–2 to 1927–8 are shown in Table VI.

§ 3. *THE MESTON SETTLEMENT EXAMINED*

The Division of Functions between the Central and Provincial Governments

So far we have considered the defects of dyarchy and their reactions on the working of the financial arrangements. Incidentally we have also mentioned the effects of the unforeseen economic circumstances which coincided with the early years of the working of the Reforms. Lastly, we have to discuss the question as to whether the Meston Settlement was fair and equitable or not.

The usual approach to the problem is to examine the adjustment of Governmental functions to revenues. The ideal distribution of Governmental functions in relation to revenues among competing tax jurisdictions would be to harmonize the yield and elasticity of revenue with the growing needs of the

TABLE VI

PROVINCIAL CONTRIBUTIONS TO THE CENTRAL GOVERNMENT[1]

(IN THOUSANDS OF RUPEES)

PROVINCES	1921–2	1922–3	1923–4	1924–5	1925–6	1926–7	1927–8 (b)
Madras	3,48,00	3,48,00	3,48,00	3,48,00	2,21,98	1,65,19	
Bombay	56,00	56,00	56,00	56,00	34,00	28,00	
Bengal	63,00	(a)	(a)	(a)	(a)	(a)	
United Provinces	2,40,00	2,40,00	2,40,00	2,40,00	1,83,83	1,50,85	
Punjab	1,75,00	1,75,00	1,75,00	1,75,00	1,13,84	85,73	
Burma	64,00	64,00	64,00	64,00	44,35	50,23	
Bihar and Orissa	...	...	...	...	...	...	
Central Provinces	22,00	22,00	22,00	22,00	13,00	22,00	
Assam	15,00	15,00	15,00	15,00	9,00	15,00	
Coorg	...	...	...	12	12	12	
TOTAL ...	9,83,00	9,20,00	9,20,00	9,20,12	6,20,12	5,17,12	

[1] Source: Cmd. 3610 (1930).

(a) Contribution remitted.

(b) The entire amount of the contributions was remitted in 1927–8.

Government. This, however, is rarely done. Hence the functions of overlapping tax jurisdictions always require transfers of funds from one jurisdiction to another.[1]

The problem of financial relationships between the Central and Provincial Governments in India cannot be harmonized on account of constitutional and administrative difficulties.[2] The Montford Reforms were a transitional stage in the constitutional evolution of the country. Under the Reforms scheme the Central Government was mainly responsible for defence, debt services and the commercial departments (railways, posts and telegraphs) of the Government of India. The Provinces were charged with the development of 'nation-building' services. Such a distribution of Governmental activities was entirely due to administrative convenience and political reasons.

The financial allocation of resources was a necessary corollary of the functions assigned to the Central and Provincial Governments. The functions of Government can be arranged in an ascending scale of urgency, ranging from those which concern the comfort and well-being of the individual to those which secure the existence of the State.[3] In every country the Central or Federal Government's basic obligation of maintaining the country's defence does not apparently affect or benefit the life of an average citizen; while the activities of the State or Provincial Governments deeply concern his daily life. The average citizen is more interested in the activities of the Provincial Governments which drive out malaria, spread education, provide hospitals and dispensaries and prevent theft, than in the Central Government which keeps out the phantom foreign invader, controls the intricate policy of foreign exchanges, explores regions in the eternal snow of the Himalayas and builds capitals amidst the ruins of Empires.[4] Thus the funds of the Provincial Governments require a flow of capital capable of vast expansions to carry out their ever-increasing activities on 'nation-building' departments. But under the

[1] See ch. i, p. 25. [2] See ch. i, p. 8

[3] Cmd. 9109 (1918), par. 188.

[4] Sir Basil Blackett did not favour the huge expenditure on the New Delhi scheme being met out of revenue. See his speech in introducing the Finance Bill, 1923-4.

new allocation of resources this was not the case. For the rapidly expanding needs of the Provinces the sources of revenue assigned were inelastic and insufficient.

The Provincial Sources of Revenue were Inelastic

Land Revenue was the mainstay of provincial finance under the reformed constitution. In permanently settled parts of the country the yield from land revenue is not capable of any appreciable increase. The financial difficulties of Bengal and its claim for special treatment in the fixation and remission of provincial contributions were due to this highly inelastic source of revenue.[1] In other Provinces as well, on account of long-term settlements and the changed policy for reducing the burden of the cultivators followed in recent settlements, the increase in land revenue has not kept pace with its earlier yield.[2] Though the net income from land revenue in 1925–6 was Rs. 6,41 lakhs greater than in 1901–2, its percentage in 1925–6 as compared with 1901–2 fell from 42 to 21 per cent of the total net revenue of the Central and Provincial Governments.[3]

The other provincial heads of revenue either required a large capital outlay for their development (e.g. forests) or on account of other reasons were not capable of much expansion. On the whole, the Provincial Governments had inelastic sources of revenue for their rapidly expanding needs.[4]

The Central Sources of Revenue were Elastic

On the other hand the Central Government for its comparatively stationary needs had expanding sources of revenue. The yield of the three sources of revenue, namely customs, income-tax, and salt, can be seen from the following statement:

[1] See p. 154. [2] See chs. vii and xiii.

[3] ANSTEY, op. cit., p. 368. See also the footnote on the same page for an excellent table showing a comparative view of the change in the relative importance of certain outstanding sources of Indian revenue during 1883–4—1923–4. See also Table XIII, p. 218 (ch. ix).

[4] Chs. (vii–ix) discuss in detail the various heads of provincial revenue.

RECEIPTS FROM CUSTOMS, INCOME-TAX AND SALT[1]

YEAR	CUSTOMS	INCOME-TAX	SALT
	(IN THOUSANDS OF RUPEES)		
1921–2	34,37,42	22,17,54	5,97,52
1922–3	41,29,24	18,13,94	6,42,36
1923–4	39,64,40	18,49,12	9,63,97
1924–5	45,69,27	16,21,23	7,02,67
1925–6	47,68,09	16,12,04	5,92,69
1926–7	47,28,31	15,98,28	6,31,63
1927–8	48,11,54	15,42,63	6,22,15
1928–9	49,11,89	17,05,64	7,20,43
1929–30	51,12,59	17,06,34	6,36,76
1930–1	46,64,27	16,30,97	6,44,09
1931–2	46,25,49	17,56,95	8,35,52
1932–3	51,67,47	18,00,31	9,83,29
1933–4	46,85,58	17,15,89	8,51,24
1934–5	52,36,50	17,58,04	7,63,67
1935–6	53,77,59	17,09,95	8,06,11

Thus one of the chief defects of the Meston Settlement was that while it made the Provinces responsible for the development of the 'nation-building' activities, the sources of revenue which it placed at their disposal were inelastic. The unpopularity of the Reforms was largely due to the difficulties in finding additional sources of revenue.[2] Nor must it be forgotten that for this state of affairs the Provincial Governments were

[1] Sources: Cmd. 3291 (1928), Cmd. 5804 (1938).

[2] The Muddiman Committee observed: 'It is due to it (i.e. the Meston Settlement) that ministers have been unable to enter upon a policy of progressive development in the spheres of administration committed to their care. If they had been able to do so, they would have been able to provide an answer to those critics who have reiterated the allegation that the Reforms were a sham, and they would also have been able to consolidate their position or else have been required to make way for other ministers who could have

themselves responsible to some extent by not developing some of the sources of revenue suggested by the Taxation Enquiry Committee, e.g. succession duties.[1] No doubt in the early years of the Reforms there was considerable difficulty in imposing increased taxation due to the persistent political opposition, but the atmosphere had considerably improved in the later years of the working of the constitution. The failure to develop new sources of revenue resulted in creating gross inequalities of burdens between the different sections of the community.[2]

The Necessity for Provincial Contributions

The provincial contributions formed an important feature of the Meston Settlement. We must brush aside the common notions about provincial contributions which are widely held in India. The late Mr Gokhale, one of the strongest advocates for a system of federal finance for India, in his evidence before the Decentralization Commission, outlined a scheme of federal finance in which the Provinces were to contribute to the Central Government.[3] Professor Seligman also favoured the system of contributions from the Federal or Central to the State or Provincial Governments or vice versa.[4] A clear-cut division of functions and resources between various tax jurisdictions

enunciated a policy more acceptable to the Councils which would incidentally have assisted in the establishment of the responsibility of the ministers to the Councils.' *Report of Reforms Enquiry Committee*, 1924. *Majority Report*, par. 56. Cmd. 2360 (1925).

[1] See chapters vii and ix.

[2] See ch. ix, § 4.

[3] Mr Gokhale in his evidence before the Decentralization Commission remarked: 'There should be no divided heads of either revenue or expenditure, but certain heads of revenue with the expenditure under them should be wholly imperial and the others wholly provincial . . . on this basis of division, the revenues of all the Provincial Governments will be found to exceed their present scale of expenditure, while the reverse will be the case with the Government of India. To make up this deficit of the Supreme Government, the Provincial Governments should make to it fixed annual contributions, which should be determined after a careful consideration of the average liability of each province to famine as also of the need of making increased grants to local bodies out of provincial resources.' Cmd. 4360 (1908), p. 58.

[4] SELIGMAN, *Essays in Taxation*, 10th edition, pp. 663–9. See ch. i for a discussion of the question.

is only thinkable in a new island recently inhabited in which primitive conditions prevail. But even there after some time mutual adjustment of functions and resources among the competing tax authorities would necessitate transfers of funds from one tax authority to another, as the financial history of several federations has proved.

Starting with the principle that the system of contributions is an acknowledged method of transferring funds from one tax jurisdiction to another, let us examine the various methods which the Committee could have adopted for calculating the contributions. These can be arranged as follows:

(i) *Contributions in Proportion to Expenditure:* This recognizes thrift and penalizes extravagance. But as the expenses of Provincial Governments vary largely from Province to Province due to differences in cost of administration and responsibility, such a method, taken by itself, would create inequalities of burdens. Bombay, for example, on account of its high cost of administration, would be penalized under the scheme. Moreover, it may lower the efficiency of administration by cutting down necessary expenditure in the race for false economy between various Provinces. The relative positions of the various Provinces on the basis of a levy in proportion to expenditure based on the expenditure figures settled at the Simla Conference can be seen from the following table:

Provinces	Normal expenditure settled at the Simla conference	Order in point of expenditure	Contributions fixed by the committee	Order in point of the contributions
	Rs. lakhs		Rs. lakhs	
Madras ...	10,55	2	3,48	1
Bombay ...	10,99	1	56	6
Bengal ...	7,92	4	63	5
United Provinces	8,63	3	2,40	2
Punjab ...	7,33	5	1,75	3
Burma ...	7,21	6	64	4
Bihar and Orissa	4,18	7	nil	...
Central Provinces	4,14	8	22	7
Assam ...	1,63	9	15	8

(ii) *Contributions Based on Population:* This provides a rough and ready method of assessing a levy, but it would not result in an equitable distribution of burdens. Population alone in a large country like India with its different parts unequally economically developed is a bad index for the measurement of the paying capacity of a Province. Such a levy would demand from the thickly populated backward Province of Bihar and Orissa a far higher amount than from Bombay with its vast industrial concerns. The relative paying position of the nine Provinces on the basis of population can be seen from the following table.

PROVINCES	POPULATION (IN MILLIONS)	ORDER IN POINT OF POPULATION	CONTRIBUTIONS FIXED BY THE COMMITTEE	ORDER IN POINT OF THE CONTRIBUTIONS
			RS. LAKHS	
Madras	42·3	3	3,48	1
Bombay	19·3	6	56	6
Bengal	46·7	1	63	5
United Provinces ...	45·4	2	2,40	2
Punjab	20·7	5	1,75	3
Burma	13·2	8	64	4
Bihar and Orissa ...	34·0	4	nil	...
Central Provinces...	13·9	7	22	7
Assam	7 6	9	15	8

(iii) *Contributions Proportionate to Revenue:* This also is not a fair basis because the sources of revenue which are left to the Provinces bring different amounts of income. Land Revenue is a very important source of revenue to the Punjab and the United Provinces, while owing to the Permanent Settlement it is a relatively small and a highly inelastic source of revenue in Bengal and Bihar and Orissa. A levy proportionate to revenue would result in increasing the taxation of those who are already most heavily taxed. The comparative position of the Provinces on the basis of a levy proportionate to revenue based on the Simla Conference figures as compared with the contributions fixed by the Committee are shown in the following table:

Provinces	Normal revenue settled at the Simla conference	Order in point of revenue	Contributions fixed by the committee	Order in point of the contributions
	Rs. lakhs		Rs. lakhs	
Madras ...	14,42	1	3,48	1
Bombay ...	11,48	3	56	6
Bengal ...	7,73	6	63	5
United Provinces	12,07	2	2,40	2
Punjab ...	9,62	4	1,75	3
Burma ...	8,12	5	64	4
Bihar and Orissa	4,15	8	nil	...
Central Provinces	4,21	7	22	7
Assam ...	1,79	9	15	8

From the above table it is clear that if contributions based on revenue had been accepted the position of Bombay would have been seriously affected. Bombay's position was sixth in the Meston Settlement while it would have occupied the third place on the basis of a levy proportionate to revenue. The position of the United Provinces and Madras would not have been affected.

(iv) *A Levy Proportionate to Surpluses:* This method was actually adopted by the authors of the Reforms. As noted in chapter iii this method was highly unfair—as it penalized thrift and encouraged extravagance. It takes into consideration the highest scale of expenditure and the lowest scale of revenue. The Meston Committee rightly abandoned it and adopted a new basis for its levy. The relative position of the various Provinces on the basis of the Montford Reforms and the Meston Settlement are placed side by side in the following table:

Provinces	Contributions proposed by the authors of the Report	Order in point of contributions proposed by the Report	Contributions fixed by the Meston Committee	Order in point of contributions fixed by the Committee
	Rs. lakhs		Rs. lakhs	
Madras ...	4,28	1	3,48	1
Bombay ...	88	5	56	6
Bengal ...	69	6	63	5
United Provinces	3,27	2	2,40	2
Punjab ...	2,18	3	1,75	3
Burma ...	1,40	4	64	4
Bihar and Orissa	39	7	nil	...
Central Provinces	36	8	22	7
Assam ...	13	9	15	8

The above table is instructive in pointing out that the relative position of Madras and the United Provinces in the scale of contributions was the same under both the Montagu-Chelmsford Reforms and the Meston Settlement. While Bombay was fifth under the Reforms scheme, it was sixth under the Meston Settlement.

(v) Lastly, *Contributions on the Basis of the Increased Spending Power, under the new allocation of resources:* This system was adopted by the Meston Committee. But the Committee tempered this principle in the light of the actual economic circumstances of each Province. Thus the backward Province of Bihar and Orissa was entirely exempted from the payment of the initial contributions. Burma, Assam and the Central Provinces were also given special treatment. Bombay, Bengal, the United Provinces, the Punjab and Madras were treated equally.[1]

The so-called Injustice of the Meston Settlement Examined

This new allocation of resources was universally condemned by all the Provinces.[2] The contributions fixed by the

[1] See ch. iii.

[2] For the views of the Provincial Governments on the Meston Committee Report see Cmd. 974 (1920).

Committee were thought to be highly unfair and inequitable. Each Province had its own grievance and it made the most of it. Bengal pointed out that her financial difficulties were peculiar and greater than those of the other Provinces on account of the Permanent Settlement.[1] The Joint Select Committee had also recommended that Bengal should receive special consideration from the Government of India. Further, Bengal (and Bombay also) vehemently protested that under an equitable settlement the true test of what Bengal (or any other Province) was paying to the Central Government was not its contribution under the Meston Settlement, but what the Central Government actually received from it in the shape of direct or indirect contributions. Bengal argued (and this equally applied to Bombay) that on account of her wealth, population, trade and industries, the monopoly of jute trade and the port of Calcutta, her contribution to the Central Government in the shape of income-tax, super-tax and customs (apart from other items) far exceeded that of most other Provinces.[2] Madras felt that she was the milch-cow and was proportionately contributing a larger share towards the Imperial deficit than any other Province. The United Provinces and the Punjab had the grievance that they were hard hit on account of the heavy contributions and the remaining revenues did not leave enough surplus to develop their potential industrial activities. Bombay lodged a protest that as an industrial province with a high cost of administration she had been most unfairly treated in the matter of income-tax, which she regarded as her best source of income. Bihar, even though she was contributing nothing, protested that as a backward province she required a large capital expenditure to bring her into line with the advanced industrial province of Bengal which had so far ignored her development and requirements. The Central Provinces made further claims upon the Central Government on account of her backward condition. Assam loudly protested that unless the arrangement was quickly changed her Government was 'predoomed to impotence and failure'. Lastly, Burma claimed larger revenues to develop her vast natural resources.[3]

In this sharp conflict of inter-provincial claims of interests,

[1] See ch. vii. [2] See ch. i. [3] Cmd. 974 (1920).

it was exceedingly difficult to achieve justice. Bearing in mind the past inequalities of treatment, and the differences of uneven economic development, let us examine the claims and counter-claims of the Provinces over the injustice of the Meston Settlement.

The fallacious arguments of Bengal and Bombay claiming special treatment were based on the so-called indirect contributions made by them to the Imperial revenues. The Bengal Government in its reply of June 2, 1920, to the proposals of the Financial Relations Committee wrote: 'Under certain heads, e.g. railways and post and telegraphs, this [i.e. the endeavour to ascertain indirect contributions] no doubt, would be difficult, if not impossible, but there are other sources, of which the important are income-tax (including super-tax) and customs (including salt), which bulk exceedingly largely in the figures and which have a vital bearing on the whole problem.'[1] Similarly, the Bombay Government, in its reply of June 3, 1920, to the Government of India's letter, pointed out that the only solution for the success of the Reforms was to allow her half the share in the income-tax, including super-tax, collected in the Presidency.[2]

These claims are based on the assumption that each Province has a natural right to the revenues collected within its boundaries. This view is particularly indefensible in India where the tax jurisdictions were artificially made with the haphazard growth of British power in India. Let us take the most obvious examples, i.e. customs and income-tax. The customs revenue, collected in India at the important ports of Calcutta, Bombay and Karachi, is a tax paid by the consumers of imported goods living in the remotest corner of the country and not only by the people in the Provinces where the ports happen to be situated. In fact, it is impossible to find out the exact amount contributed by each Province unless we develop the most elaborate system of bonding to trace the ultimate destination of the imported goods.

Similarly, in the case of income-tax (as we have already pointed out) the place where the tax is collected is not neces-

[1] ibid. [2] ibid.

sarily the place where the tax is earned. Large public companies do business in more than one Province in India. Profits in the case of ramifying enterprises are collected at the headquarters of the business, but it is impossible to calculate exactly what percentage of the profits are earned within the Province where the business has its headquarters. Moreover, in the case of public companies the shareholders are scattered all over India elsewhere and the income-tax is collected at the head office of the business. An allocation of income-tax receipts to the Provinces on the basis of origin would result in vast inequalities of tax burdens.

But even if these difficulties could be overcome, it would be a travesty of justice to allocate such revenues to the Provinces where the tax is collected, for, as the Simon Commission rightly observed, the population of towns, and in particular that of the capital cities, builds up its economic life on that of the country as a whole, while the prosperity of the great ports has its roots in the villages of the interior as well as in those of seaboard Provinces themselves.[1] The profits of the shipping concerns, insurance companies, commercial houses and the cotton or jute mills of Bombay, Calcutta and Karachi are based on the prosperity of the country as a whole. It would be most unsound logic to attribute the revenues under these heads to Bengal or Bombay alone. On the contrary, the good fortune of the Presidencies is clearly dependent upon the general economic prosperity of the country as a whole, of which no doubt they are important parts.

Defects of the Meston System

The greatest defect of the Meston Settlement, however, lay in the fact that it created inequalities of tax burdens between the different classes of the community. It handicapped the industrial Provinces (as compared with the agricultural Provinces) in not giving them power to tax industrial activities. Thus a highly industrial Province like Bombay was administered and financed out of the taxation of small cultivators (land revenue) and the labouring classes (excise). A detailed study of the provincial budgets elsewhere shows the huge divergence between the Provinces in the extent of their dependence on

[1] Cmd. 3569 (1930), par. 279.

various classes of revenue.[1] Thus Bengal was largely financed out of the revenue from stamps arising mostly out of litigation. The prosperity of Madras and Bihar and Orissa depended largely upon the revenue derived from the sale of liquor licences. The poor cultivators of the United Provinces were made the scapegoat of the burdens and penalties of the costly administrative machinery. Thus the growth and development of education, hospitals and dispensaries, roads and industries, was financed in one Province from the income from litigation, in another from the excessive consumption of the much-hated liquor and in a third from the revenue derived from a highly indebted peasantry! A sad commentary on the distribution of burdens between the various sections of the community!

Again, it is significant to note that under the Meston Settlement, though the Provincial Governments provided law and order and improved the conditions of living in the Provinces, an average citizen in urban areas who did not consume 'country' liquor or involve himself in litigation did not contribute anything towards the provincial finances. Hence the great majority of the people in cities were mainly contributing to the central finances (e.g. in customs, salt-tax or income-tax) though they were mainly benefited by the activities of the Provincial Governments. Division of income-tax or excise duties is the only practicable way to remove such a defect.[2]

The relative importance of the principal sources of revenue to the total revenue of the Province is shown in Table VII.

Conclusion

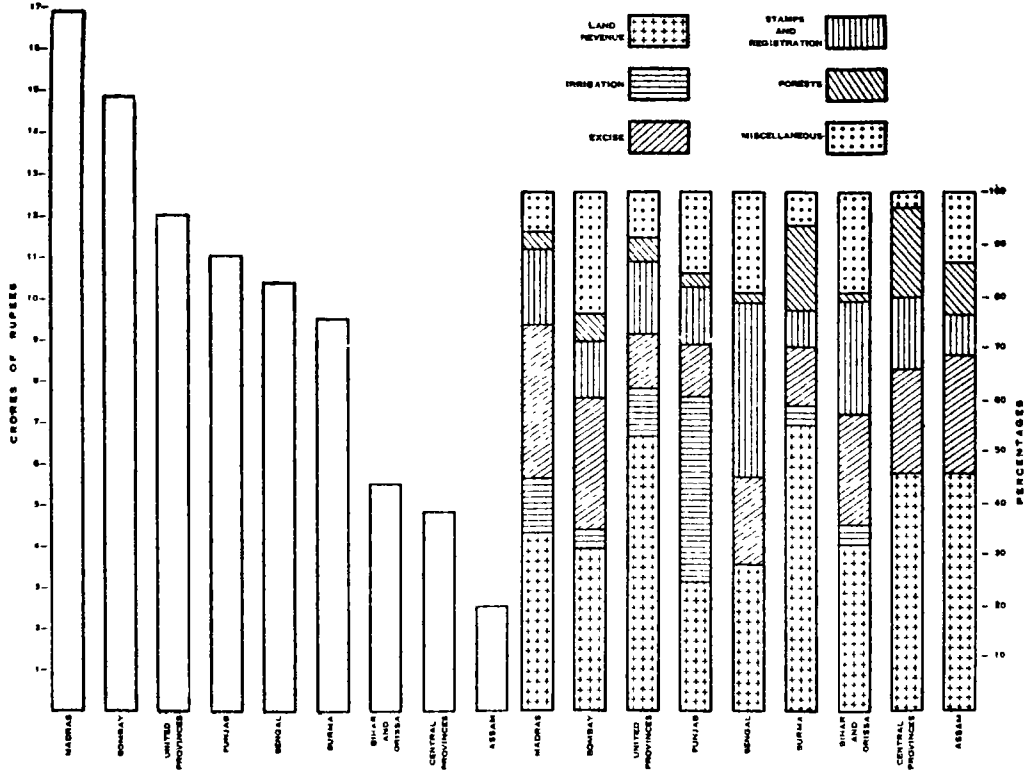
In conclusion it may be noted that the Meston Settlement has not been studied in a scientific impartial spirit. Overzealous provincial patriotism has produced a coloured picture in which the real facts have been kept in the background. Those who condemn the Meston Settlement are out of court unless they can suggest a better alternative scheme ***within the constitutional machinery*** of the Reforms. It was not an ideal system and it never claimed to be. It was in harmony with the spirit of the Reforms. Change the character of the Reforms and the Meston Settlement is thrown overboard. The Meston

[1] See chs. vii, viii and ix. [2] See ch. i.

TABLE VII

RELATIVE IMPORTANCE OF THE PRINCIPAL HEADS OF REVENUE TO THE TOTAL REVENUE OF THE PROVINCE

PROVINCES	TOTAL PROVINCIAL REVENUE AVERAGE 1925–35	PERCENTAGE OF LAND REVENUE TO THE TOTAL REVENUE OF THE PROVINCE	ORDER IN POINT OF PERCENTAGE	IRRIGATION	ORDER	EXCISE	ORDER	STAMPS	ORDER	REGISTRATION	ORDER	FORESTS	ORDER
	Rs. 1,000												
Madras	16,81,57·8	34·9	5	10·2	2	29·3	1	13·7	4	2·1	2	3·1	6
Bombay	14,77,01·7	31·6	7	3·38	5	25·1	2	11·0	6	0·9	5	4·4	5
Bengal	10,32,74·9	28·3	8	−0·017	...	17·2	6	30·9	1	2·7	1	2·3	8
United Provinces ...	12,00,76·8	52·8	2	8 85	3	10·6	8	14·4	3	1·1	4	4·6	4
Burma	9,48,76·0	55·6	1	3 24	6	11·4	7	6·4	9	0·6	7	16·0	2
Central Provinces ...	4,89,32·9	46·1	3	0·15	7	20·1	5	12·6	5	1·2	3	17·5	1
Assam	2,50,75·3	45·8	4	...	...	22·6	3	8·1	8	0·8	6	9·9	3
Punjab	10,98,85·0	25·2	9	35·59	1	10 0	9	10·3	7	0·8	6	2·6	7
Bihar and Orissa ...	5,49,34·6	31·9	6	3·93	4	21·3	4	19·8	2	0·9	5	1·5	9



PROVINCIAL REVENUES 1925–35 ANNUAL AVERAGE: ROUGH GRAPHICAL REPRESENTATION OF TABLE VII

Settlement has received more destructive than constructive criticism.

Above all, it must always be remembered that India as a whole is much bigger than any of the Provinces. The vital interests of the whole country are much more important than the isolated problems of any of the Provinces. If the credit of India had been seriously shaken in the economic blizzard that swept over the country between 1921–4, what would have become of the Provinces?

Provincial autonomy would have ended in smoke. We must realize that we are citizens of India first and citizens of the Provinces or States next. Over-zealous provincial patriotism is bound to breed jealousies which are highly detrimental to the progress of the country. The true line of patriotism lies in a frank and free recognition of the greater needs of the country as a whole in subordination to the needs of the parts. The sooner this maxim is realized the sooner the different parts of the country will march together towards the harmonious development of the whole country.

V

PROVINCIAL AUTONOMY

§ 1. *CONSTITUTIONAL BASIS*

Provincial Autonomy a Natural Development

'The Provinces are the domain', wrote the authors of the Montagu-Chelmsford Reforms, 'in which the earlier steps towards the progressive realization of responsible government should be taken. Some measure of responsibility should be given at once, and our aim is to give complete responsibility as soon as conditions permit.' The reforms of 1919 were a transitional stage in the introduction of provincial autonomy. The reforms had introduced a large measure of responsible government in the Provinces, but after working for more than a decade it was felt that a stage had been reached when the limits imposed by the Act of 1919 should be considerably extended. The lines of the future reforms were examined by the Statutory Commission (1930). The principles of the constitutional settlement recommended by the Statutory Commission, however, were not favourably received in India. Meanwhile, Indian political opinion became keenly conscious of the imperfections of the Indian polity so long as there was no constitutional relationship between the Indian States and British India. The three Indian Round Table Conferences and the Joint Committee on Indian Constitutional Reforms (1933–4) resulted in the passing of the Government of India Act 1935. This Act established provincial autonomy in the Provinces (1937) and proposed to create an All-India Federation by means of which the Indian States and Provinces should decide policies affecting India as a whole.

Distribution of Legislative Powers

The Act of 1935 recognized three classes of subjects: (i) exclusively federal, (ii) exclusively provincial and (iii)

concurrent.[1] This means that functions like defence, foreign relations, navy and air force, railways, currency and coinage and public debt have been reserved for the federal authority. Secondly, education, medical, public health, police, law and order have been reserved for the Provincial Governments. Finally, there is a class of functions (e.g. employers' liability and workmen's compensation, trade unions and welfare of labour) in which the Central Legislature has concurrent powers of legislation with the Provincial Legislatures, with provision for resolving a possible conflict of laws. In all federations it has been found necessary to provide the Central Legislature with legislative jurisdiction throughout the country to secure uniformity in the main principles of law, and to permit the Provincial Legislatures to vary the laws to meet the particular circumstances of a Province. The Concurrent legislative list provides for such cases.

As a result of this division of functions the Provinces possess an exclusive authority to legislate on the Provincial subjects. This authority is broadly free from the Central Government and Legislature. In the Concurrent field of legislation the Provinces can vary the laws to suit local conditions.

Essence of Provincial Autonomy

The essence of provincial autonomy, as understood by the Joint Committee on Indian Constitutional Reforms (1933-4), consists in each of the Governor's Provinces possessing an executive and a legislature having exclusive authority in a precisely defined sphere, within which it is broadly free from control by the Central Government and legislature. This represents a fundamental departure from the reforms of 1919, under which the Provincial Government exercised a *devolved* and not an *original* authority. Under provincial autonomy the Central

[1] The subjects in List I, i.e. the Exclusively Provincial list, represent generally, with certain additions, those which the Devolution Rules under the Act of 1919 earmarked as 'Provincial Subjects'. See Appendix II for Lists I, II and III. For the list of more important Provincial Subjects under the Act of 1919 see p. 59.

The dyarchic system in the Provinces by which the subjects were divided as 'Reserved' and 'Transferred' has been abolished.

Government and legislature have ceased to possess in the Governor's Provinces any legal power or authority with respect to any matter falling within the exclusively Provincial list of subjects, except that of supervision under certain conditions. The provincial executive, with the Governor as its head, is entirely responsible for provincial administration and maintenance of law and order.

Main Features of Provincial Autonomy

There are thus three main features of provincial autonomy. In the first place it has abolished the dyarchic system introduced by the reforms of 1919. The division of provincial subjects into 'reserved' and 'transferred' has been abolished, and the provincial ministers are now generally responsible over the whole field of provincial government.

Secondly, the provincial executive are responsible for the fundamental functions of government: the enforcement of law and order, and the maintenance of an upright administration. This responsibility has raised a wider question, namely, the relationship of the provincial ministers with the Governor as the head of the provincial executive. Responsible parliamentary government, as rightly observed by the Joint Select Committee, works by the interaction of four essential factors: the principle of majority rule; the willingness of the minority for the time being to accept the decisions of the majority; the existence of great political parties divided by broad issues of policy, rather than by sectional interests; and the existence of a mobile body of public opinion, owing no permanent allegiance to any party and therefore able to keep the vessel on an even keel. In India none of these factors, as they are understood in the United Kingdom, exist. Hence it became essential to introduce some safeguards; that is, to give certain special responsibilities to the Governors.[1] The safeguards, it is understood, are not to be used

[1] The Governors have been given power to take executive action (i) to prevent any grave menace to the peace or tranquillity of the Province, or any part thereof; (ii) to safeguard the legitimate interests of minorities; (iii) to secure to the members of the Public Services any rights provided for them by the Constitution and to safeguard their legitimate interests; (iv) to administer certain areas declared in accordance with special provisions, to be 'partially

by the Governors in the daily administration of the Government. They are vested in him to hold the scales evenly between conflicting interests and to protect those who have neither the influence nor the ability to protect themselves.

Lastly, provincial autonomy has meant greater responsibility in the sphere of social administration. The Government of India has always followed a policy of neutrality and non-interference in all social and religious matters in India. It is a curious paradox, as Dr Anstey has aptly observed, that 'nothing would end British rule in India more quickly than any attempt to introduce just those reforms which would do most to improve the well-being of the masses'.[1] This policy of non-interference, however justifiable it may have been in the past, now needs a revision to carry into effect social legislation in such matters (to name only two obvious instances) as child-marriage and the problem of untouchables. Such reforms can only be carried out under responsible government. Provincial autonomy offers the widest scope for that social legislation on which the future progress of India depends.

Provincial autonomy has thus established a substantial measure of responsible government in the Provinces. It is, however, necessary to realize that Indian constitutional problems are different from the constitutional problems of other countries. The responsible Government of India must be different from that of England. For responsible Government is not an automatic device which can be manufactured to specification. Hence provincial autonomy in India has been moulded to suit social conditions and national aptitudes. It is from this point of view that some necessary safeguards have been inserted in the Instrument of Instructions. These safeguards have not lowered the value of provincial autonomy but have strengthened the executive. Finally, it must be remembered that the success of a constitution depends far more upon the manner and spirit in which it is worked than upon its formal provisions.

excluded' areas; (v) to secure the execution of orders lawfully issued by the Governor-General.

The Governor of Sind has a special responsibility for the administration of the Sukkur Barrage and Canals Scheme.

[1] ANSTEY, op. cit., p. 474.

§ 2. *THE CHANGES IN THE FINANCIAL SYSTEM*

Introductory

The problem of the allocation of resources between the Federation and the Units is necessarily one of difficulty. The problem would be simplified if it were possible to allocate separate sources of revenue to the two authorities which would fit in with the economic and financial requirements of each party. This, however, is not a problem easy of solution. It has often been found that the yield from the sources of revenue assigned to the units or the centre is either deficient or in excess of their requirements, and hence a system of grants-in-aid or subventions is normally adopted to balance the budget.[1]

In British India the problem is not a new one. A system of doles from the Centre to the Provinces or contributions from the Provinces to the Centre, or a system of shared revenues, has often been adopted between the two parties.[2] Together with this division of resources there always was a division of the functions to be performed by each party. Past experience has shown that the sources of revenue assigned to the Provinces were always inadequate for the full development of their social needs. Hence there has always been an attempt from Provinces to demand a larger share of the resources of the Centre.

With the entry of the States into the Federation the question became one of formidable difficulty. The Butler Committee (1928–9) and the Davidson Committee (1932) tried to solve the problem. The demand of the Provinces that the States should share the burden of the income-tax and the corporation tax, and the claim of the States that they should share the proceeds of the Customs complicated the situation. The States' contributions to the Government of India and the rights of the maritime States in relation to sea customs presented problems of unusual difficulty.[3]

[1] See pp. 28 ff.

[2] See chs. ii, iii and iv.

[3] For the literature on the subject see:

(1) Report of Indian States Committee (i.e. Butler Committee), 1928–9.

(2) Report of the First Federal Finance Sub-Committee (i.e. Peel

In order to understand the present allocation of sources of revenue between the Centre and the Units it is essential to study the subject in two parts: first, the allocation of the sources of revenue between the Federation and the Units; and second, the financial position of the deficit Provinces.

Allocation of Sources of Revenue between the Federation and the Federal Units

The Meston Scheme, from the practical financial point of view, by allocating separate fields of taxation to the Government of India and the Provinces aimed to introduce a federal system of finance. The working of the system led to three conclusions: (i) that the Provinces rarely had incomes adequate for a full development of their social needs; (ii) that the division of the heads of revenue between the Centre and the Provinces left the Centre with elastic heads of revenue; (iii) that the system of reserving taxes on income for the Centre handicapped the more industrialized Provinces like Bombay and Bengal.[1] An attempt has been made in the Government of India Act 1935 to remove these defects. Under this Act the sources of revenue due to the Federation and the Federal Units have been allocated thus:

I. PROVINCIAL

(*A*) *Taxes Levied and Collected by Provinces*

1. Land revenue.
2. Irrigation.

Committee, October 9, 1931) (Indian Round Table Conference, second session).

(3) Report of the Federal Finance Committee (i.e. Percy Committee, 1932, Cmd. 4069).

(4) Report of the Federal Finance Committee (Second Peel Committee, 1932–3, Cmd. 4238).

(5) Report of the Indian States Enquiry Committee (Financial) 1932 (Davidson Committee).

(6) White Paper (December, 1931).

(7) Report of the Joint Committee on Indian Constitutional Reforms, 1933–4.

(8) The Government of India Act, 1935.

(9) Indian Financial Enquiry Report (Sir Otto Niemeyer's Report, 1936, Cmd. 5181).

[1] See ch. iv.

3. Duties of excise on the following goods manufactured or produced in the Province and countervailing duties at the same or lower rates on similar goods manufactured or produced elsewhere in India:—

(*a*) alcoholic liquors for human consumption;

(*b*) opium, Indian hemp, and other narcotic drugs and narcotics, non-narcotic drugs;

(*c*) medicinal and toilet preparations containing alcohol or any substance included in sub-paragraph (*b*) of this entry.

4. Taxes on agricultural income.

5. Taxes on lands and buildings, hearths and windows.

6. Duties in respect of succession to agricultural land.

7. Taxes on mineral rights, subject to any limitations imposed by any Act of the Federal Legislature relating to mineral development.

8. Capitation taxes.

9. Taxes on professions, trades, callings and employments, subject, however, to the provisions of section 124A (1) of the Government of India Act.

10. Taxes on animals and boats.

11. Taxes on the sale of goods and on advertisements.

12. Cesses on the entry of goods into a local area for consumption, use or sale therein.

13. Taxes on luxuries, including taxes on entertainments, amusements, betting and gambling.

14. Stamps and registration.

15. Dues on passengers and goods carried on inland waterways.

16. Tolls.

17. Fees in respect of any of the matters in the Provincial Legislative List, but not including fees taken in any court.

(*B*) *Taxes Levied and Collected by the Federation but Assigned to the Provinces*

1. Duties in respect of succession to property other than agricultural land.

2. The rates of stamp duty in respect of bills of exchange,

cheques, promissory notes, bills of lading, letters of credit, policies of insurance, proxies and receipts (as mentioned in Federal Legislative List I, item 57).

3. Terminal taxes on goods or passengers carried by railway or air.

4. Taxes on railway fares and freights.

(*C*) *Taxes Divided between the Federation and the Provinces and the Federated States*

1. Taxes on income other than agricultural income.

2. Salt duties.

3. Duties of excise on tobacco and other goods manufactured or produced in India except

(*a*) alcoholic liquors for human consumption;

(*b*) opium, Indian hemp and other narcotic drugs and narcotics, non-narcotic drugs;

(*c*) medicinal and toilet preparations containing alcohol, or any substance included in sub-paragraph (*b*) of this entry.

4. Export duties (with special provisions for the Jute Export duty, Section 140 (2), Government of India Act).

II. FEDERAL

(*A*) *Taxes Levied and Retained by the Federation*

1. Corporation tax.

2. Currency and coinage.

3. Federal railways.

4. Post and telegraph including telephones, wireless, broadcasting, and other like forms of communication.

5. Import and export duties (with exceptions mentioned above).

6. Military receipts.

(*B*) Besides, the Federal Authority may also retain in part or whole the revenues from any of the sources mentioned in (*C*) above.

Distribution of Income-tax and Corporation Tax

It will appear from the above allocation of resources between the Federation and the Units that the most important changes

in the allocation in comparison with the Meston Scheme have been with reference to (i) income-tax, (ii) corporation tax and (iii) excise and export duties.

The first Peel Committee (1931) recommended that income-tax should be Provincial and corporation tax Federal. Income-tax was, however, in the interest of efficiency and uniformity of rates, to be collected by the Federal Government, and the net proceeds were to be redistributed to the Provinces. The redistribution of the proceeds among the Provinces was a convenient way of alleviating the burden of some of the Provinces which are poorer than others. The actual process of distribution was left to the Percy Committee.[1]

The Percy Committee (1932), after a careful examination of the future finances of the Federal Government, came to the conclusion that the transference of the entire income-tax to the Provinces would cause a huge permanent deficit in the Central finances. They therefore recommended that income-tax should be retained by the Federal Government, and a percentage of it should be transferred to each Province. In addition, the Federal Government should also retain: (i) the tax paid by residents in the Federally Administered Areas and (ii) the tax paid on the salaries of federal officers. The corporation tax was to remain a federal source of revenue. The Committee recommended that the provincial contributions should be extinguished by annual stages over a definite period, such as ten or fifteen years.

As regards the principles of distribution of income-tax receipts, the Committee considered allocation on the basis of *collection*, *population*, *origin* and *residence*. Each of these methods was open to objection. Allocation on the basis of *collection* would have led to gross injustice as between Province and Province. Companies, operating over large areas, are assessed at their head office, which is often situated in an industrially more advanced Province. Moreover, interest on securities held all over the country is paid at the Public Debt offices in Calcutta, Bombay and Madras. Thus the mere accident that the income is assessed at a certain place is no reason why the benefit should go to that particular Province. This basis was, therefore, ruled out.

[1] Cmd. 4069 (1932).

Distribution by *population* has no scientific basis because industrially-advanced rich Provinces may have a small population. Yet population can be adopted with advantage for the distribution of taxes on certain forms of income which cannot easily be assigned to any particular locality, such as the undistributed profits of Companies and the income of non-residents.

Allocation on the basis of *origin* is theoretically sound, but administratively it is not workable in respect of the income of individuals and even in respect of the income of Companies it would be workable only if the allocation were to be made wholly on arbitrary lines 'either by investing income-tax officers with unlimited discretion, or by laying down uniform rules of allocation, irrespective of widely varying conditions'. This method, hence, was also not adopted.

The Committee adopted *residence* (i.e. the tax actually paid by the residents of a Province) as the basis of the allocation. Each Province was credited with the tax paid by persons resident in it (i.e. by individuals, Hindu undivided families, unregistered firms and certain associations), including tax on dividends received by them from Companies. In allocating ordinary income-tax on this basis there were, however, practical difficulties. As a substantial part of the ordinary income-tax is collected at the source and no formal assessment is made, on the assumption that the taxpayer has no other source of income, it was difficult to ascertain the amount of tax which should be credited to each Province. The Committee recommended that the records should be modified in such a way as to facilitate the ascertainment of the personal income-tax which should be credited to each Province. Meanwhile, they thought the only practicable course was to throw all the personal income-tax (i.e. excluding personal super-tax) into a common pool and to distribute this pool between the Provinces on the estimated basis of the probable amount of tax paid by the residents on their incomes. As regards personal super-tax which is, generally speaking, collected after formal assessment, there could be no difficulty. It was to be credited to the Province where the assessment was made.

The proceeds from the assessment of the income of

non-residents and undistributed profits of Companies were to be distributed on the basis of population. This would have helped, to some extent, the poorer Provinces with large populations such as Bihar, Orissa and the United Provinces.

The Distribution Proposed

On the basis of the above recommendations the proceeds were to be distributed in the following manner:

	Rs. lakhs
Total Gross Yield of Income-tax	18,00
Less Cost of Collection	80
Net yield ...	17,20
Super-tax on Companies, Tax on Salaries of Federal Officers and Personal Income-tax and Super-tax levied in Federal Areas (to be Retained by the Federal Government)	3,70
Balance Available for Distribution to the Provinces ...	13,50

Out of the total, about Rs. 2,00 lakhs represented personal super-tax (i.e. other than Company super-tax) and was to be distributed on the basis of actual collections from residents. Of the balance of Rs. 11,50 lakhs, about one-seventh was approximately estimated to be the tax on the undistributed profits of Companies and on the incomes of non-resident persons. This amount (i.e. one-seventh of Rs. 11,50) was to be distributed on the basis of population. The remaining six-sevenths was to be distributed on the basis of the estimated share of personal income-tax creditable to each Province. The result of the distribution on the above basis is shown in Table VIII.

Though the above settlement of the Percy Committee has not been adopted under the Act (1935) yet it opened a new field of inquiry. The Committee must be given the credit for realizing the difficulties of the deficit Provinces. Their analysis of the division of income-tax in various parts has been of immense help in Sir Otto Niemeyer's settlement. Finally, the Committee came to the conclusion that perfect equality of treatment was an impossibility in any federation, let alone in India. The Committee's words may with profit be quoted here: 'It is doubtful whether a jealous comparison of relative burdens offers a sound

TABLE VIII

DISTRIBUTION OF INCOME-TAX

IN LAKHS OF RUPEES

PROVINCES	TWO CRORES ON COLLECTIONS OF PERSONAL SUPER-TAX	ONE-SEVENTH OF 11½ CRORES ON POPULATION BASIS	SIX-SEVENTHS OF 11½ CRORES ON BASIS OF PERSONAL INCOME-TAX WITHOUT FEDERAL SALARIES	TOTAL
Madras	7	30	1,46	1,83
Bombay[1]	50	14	2,79	3,43
Bengal	1,10	32	2,63	4,05
United Provinces	8	31	84	1,23
Punjab	2	15	74	91
Bihar and Orissa	18	24	65	1,07
Central Provinces	3	10	46	59
Assam	1	6	22	29
North-West Frontier Province[2]	1	2	7	10
Total ...	2,00	1,64	9,86	13,50

[1] Includes Sind. Figures for the latter in respect of Columns 2 and 4 are not readily available, but are roughly estimated at one-sixteenth (under both the columns together) of the total figure for Bombay plus Sind.

[2] The share due to the North-West Frontier Province will presumably go in reduction of the subvention to that Province.

basis for a successful partnership. Each partner in a new enterprise must bring something substantial into the common pool and may expect to derive solid advantages from the partnership commensurate with his contribution; but, if these conditions are fulfilled, the partners will be unwise to insist on a meticulous equality. They will probably find it best to take their associates as they are. Similarly, a new federation may find, at the commencement of its existence, that the conception of maintaining the *status quo* in non-essentials is a better guide to policy than any ambitious ideals of equality or uniformity.' (Par. 93.)

The Report of the Second Peel Committee[1]

The Second Peel Committee (1932), following the lines of the Percy Report, envisaged a twofold division of taxes on income into shares which would be permanently assigned to the Federal Government and the Provinces. To the Federal Government was assigned the proceeds of the tax derived from: (i) corporation tax, (ii) tax on federal officers, (iii) tax in federal areas, (iv) tax on Government securities and (v) tax on the incomes of persons not resident in British India.[2] The whole of the remaining proceeds from taxes on income was to be assigned to the Provinces. The proposals in paragraphs 74 and 75 of the Percy Report (mentioned above) were regarded by the Committee as suitable for the actual distribution of the proceeds.

At the outset of the Federation, however, in order to ensure the solvency of the Central Government, it was proposed that out of the provincial share of taxes on income the Federal Government should retain a block amount for a period of x years. This amount would be deducted by the Federal Government from the total yield before any distribution took place.

The initial amount fixed for the period of x years, it was recommended, should gradually be reduced to zero. Hence the

[1] The Report is contained in *Indian Round Table Conference* (Third Session) November 17 to December 24, 1932, Cmd. 4238 (1933).

[2] The Committee thought, on the estimate of the Percy Report, that the yield from the five heads quoted above would be 5¼ crores out of the total yield of 17¼ crores. The representatives of British India said that the Federal Government should retain only 5 crores while the States' representatives agreed to assume the burden of corporation tax if the Federal Government retained 8¼ crores (par. 4).

duration of the period was divided into two parts, during the second half of which the entire amount was to be finally allocated to the Provinces. Regarding the duration of the *x* period the Committee were unable to report agreement on account of the differences between the British Indian and the States' representatives—the former insisting on a minimum period of ten years divided into two parts of at least five years each, the latter insisting on limiting the *x* period to four or five years.

The States' representatives agreed to assume liability for corporation tax on the expiration of the period of *x* years, subject to the understanding that, assessment of the tax on the Companies in a State having been made, the State might raise the amount due to the Federation by any method it chose, and not necessarily by the actual levy of that tax.[1]

In addition to the above division of taxes on income it was recommended that, so far as British India is concerned, the Federal Government should have power to levy, for its own purposes, an additional tax on the heads of income-tax permanently assigned to the Provinces. Similarly, each Province individually was to have a right of surtax upon the personal tax levied on inhabitants under the heads permanently allocated to the Provinces, subject to a maximum of 12½ per cent of the tax centrally imposed. This surtax, like all other taxes on income, was to be collected by a federal agency.

White Paper Proposals[2]

The White Paper proposed the following solution:

(i) Taxes on income derived from federal sources were to be permanently assigned to the Federation.

(ii) Of the yield of the rest of the normal taxes on income (except the corporation tax), not less than 50 and not more than 75 per cent was to be assigned (by Order in Council) to the Provinces.

(iii) Out of the amount assigned to the Provinces the Federal Government (during a transitional period) was to retain an amount which was to remain constant for three years and was

[1] par. 8. [2] December 1931.

thereafter to be reduced gradually to zero over a further period of seven years—the Governor-General being given power to suspend these reductions, if circumstances made it necessary to do so.

(iv) The Federal Government was to be empowered to impose a surcharge on taxes on income, the proceeds of which were to be devoted solely to federal purposes.

(v) The corporation tax was to be retained by the Federation, and after ten years the tax should be extended to the States. The States, however, were given the right not to subject Companies to the tax and to pay themselves to the Federation an equivalent lump sum contribution.[1]

(vi) The Provincial Legislatures were empowered to impose a surcharge not exceeding 12½ per cent on the taxes levied on the personal income of persons resident in the Province, and to retain the proceeds for their own purpose.[2]

(vii) The Provinces were empowered to impose taxes on agricultural incomes, which are not at present subject to income-tax.

Joint Committee Report [3]

The Joint Committee suggested that the share assigned to the Provinces should not be more than 50 per cent. The determination of the actual period (3 and 7 years suggested by the White Paper) during which the Centre should retain a part of the portion assigned to the Provinces was left to be decided by an Order in Council.

The provincial surcharges of 12½ per cent on the taxes levied on the personal income of persons resident in the Province were not favoured by the Committee.

Sir Otto Niemeyer's Report

Sir Otto Niemeyer was appointed to make recommendations after reviewing the budgetary positions of the Government of India and the Provinces, on matters under sections 138 (1) and (2)—the allocation of taxes on income other than taxes on agricultural income; 140 (2)—the assignment of the net proceeds of the jute export duty; and 142—grants-in-aid to the revenues

[1] par. 142. [2] par. 57. [3] H.C. 5, I Part, 1934.

of the Provinces—of the Government of India Act 1935. As the present financial arrangements (in some respects) are based on his recommendations, a detailed study of them is necessary.

Sir Otto's aim throughout his recommendations was two-fold. He always kept in mind the stability of the central finances. Besides, his aim was that at the inauguration of provincial autonomy each of the Provinces should be so equipped as to enjoy a reasonable prospect of maintaining financial equilibrium. A real attempt has been made to remove the chronic state of deficit of some of the Provinces.

Regarding the distribution of income-tax[1] under section 138 of the Government of India Act, Sir Otto Niemeyer made the following recommendations:

(i) (*a*) That the percentage prescribed under Section 138 (1) should be 50 per cent.

(*b*) That the percentage distribution of this share to be prescribed under the same sub-section should be:

Madras	15
Bombay	20
Bengal	20
United Provinces	15
Punjab	8
Bihar	10
Central Provinces	5
Assam	2
North-West Frontier Province ...	1
Orissa	2
Sind	2

(ii) That the amount to be retained under section 138 (2) from this share should be:

> For a first period of five years, in each year, the whole or such amount as, together with any general Budget receipts from the railways, will bring the Central Government's

[1] Out of the total income-tax receipts the following deductions must be made to find out the amount available for distribution among the Provinces:

(i) Corporation tax.

(ii) Receipts from the Chief Commissioners' Provinces.

(iii) Receipts from Federal emoluments.

(iv) Cost of collection.

Of the residuum 50 per cent is allocated for provincial distribution.

share in the divisible total up to 13 crores, whichever is less; and

For a second period of five years, in the first year, five-sixths of the sum, if any, retained in the last year of the first period, decreasing by a further sixth of that sum in each of the succeeding five years.

The most difficult question was the manner in which the proceeds of taxes on income were to be distributed among the Provinces. On this contentious question, on many occasions in the past, each Province had advocated the basis of division (collection, population, origin, residence) which would have given it the largest dividend. We have already remarked that no basis possesses any scientific validity or satisfies in any appreciable degree the test of the paying capacity of a Province. And, even if we could find out exactly to what part of India particular fractions of income belong and therefore where the incidence of the taxation burden rests, 'it is still arguable that in a federation other considerations also are involved; particularly if the benefits and incidence of other forms of common taxation are unequally divided as between the various partners'.[1]

After taking into consideration the various aspects of the problem, Sir Otto fixed the percentages mentioned above, partly on residence and partly on population, paying to neither factor a rigidly pedantic deference.[2] This, perhaps, has been the best proposal for the allocation of income-tax, as between the Provinces *inter se*, since the Montagu-Chelmsford Reforms of 1919.

Corporation tax is a federal source of revenue. It is not to be levied by the Federation in any Federated State until ten years have elapsed from the establishment of the Federation. The ruler of any Federated State is, however, authorized to pay the tax himself to the Federation. The tax in such a case shall not be levied in the State. When the Ruler of a State so elects to pay the tax the officers of the Federation shall not call for any information or returns from any corporation in the State, but it shall be the duty of the Ruler to supply to the Auditor-General of India such information as he may reasonably require to enable him to determine the amount of any

[1] par. 30. [2] par. 34.

such contribution. If the Ruler of the State is dissatisfied with the determination as to the amount of the contribution payable by his State in any financial year, he may appeal to the Federal Court, and if he establishes to the satisfaction of that Court that the amount determined is excessive, the Court shall reduce the amount accordingly and no appeal shall lie from the decision of the Court on the appeal.

Deficit Provinces

We now come to the question of deficit Provinces. Sir Otto after reviewing the budgetary position of the Provinces came to the conclusion that Sind, Orissa, Assam and the North-West Frontier Province could not balance their budgets and urgently needed additional resources.

Sind. In 1936-7 the Government of India provided a subvention to Sind of Rs. 102 lakhs plus non-recurrent grants of Rs. 4 lakhs for initial equipment and election costs and Rs. 2 lakhs unallocated. In addition Rs. 17½ lakhs were provided for buildings in Karachi.

The future finances of Sind are bound up with the financial future of the Lloyd Barrage. After a survey of the prospects of the Barrage scheme Sir Otto recommended that Sind should receive a subvention of 105 lakhs for a period of 10 years (i.e. till 1946–7 inclusive); that then it should be diminished by 25 lakhs a year for 20 years; by 40 lakhs a year for the next five years; by 45 lakhs a year for the next succeeding five years and thereafter until the whole Barrage debt had been repaid the subvention should be at a rate of 50 lakhs a year. When the debt has been repaid (i.e. in about 40 years from funding in 1942) any remaining portion of the subvention will, of course, in any event cease.[1] Besides this, a single non-recurrent grant of 5 lakhs, towards the cost of a jail at Shikarpur, was also recommended.

Orissa. In 1936–7 the Government of India assisted Orissa by a grant of 50 lakhs of which 40½ lakhs was in respect of the deficit in the budget; 7½ lakhs (non-recurrent) was given for the establishment of famine and road funds and initial equipment, and 2 lakhs was an unallocated grant.

[1] par. 13.

Sir Otto recommended that the recurring grant of Orissa should be fixed at 50 lakhs. In addition a non-recurring grant of 19 lakhs should be given.[1]

Assam. The recurring grant of Assam was fixed at 45 lakhs a year. In addition 7 lakhs per year was provided towards the cost of the Assam Rifles. In view of this grant the claim of Assam for the proceeds of the excise duty on Assam oil did not require further consideration.

The North-West Frontier Province. The Province had received an annual subvention of one crore from the Government of India since 1932. This subvention under section 142 of the Government of India Act can be increased at any time without an address from the Federal Legislature.

The future subvention of the Province was fixed at 110 lakhs and it was recommended that the subsidy should be subject to revision after five years.

Subventions to Other Provinces. Apart from the specific cases of the deficit Provinces, some assistance was also recommended to other Provinces. This assistance was irrespective of the allocation of income-tax and was not affected by it. Below the whole provision is summarized:

Bengal	75 lakhs
Bihar	25 lakhs
Central Provinces	15 lakhs
Assam	45 lakhs (plus 7 lakhs in respect of the Assam Rifles, par. 15)
North-West Frontier Province	110 lakhs
Orissa	50 lakhs (plus 19 lakhs non-recurrent, and to diminish as indicated in par. 13 of the Report)
Sind	105 lakhs (plus 5 lakhs non-recurrent, and to diminish as indicated in par. 13 of the Report)
United Provinces	25 lakhs for 5 years
Total ...	450 lakhs

Decentralization of Balances and Debt Cancellation. A part of the above subventions recommended to the Provinces, Sir

[1] par. 14.

Otto suggested, could be conveniently provided by decentralization of balances and debt cancellation. On financial and administrative grounds the proposal was also extremely desirable. In so far as the Provinces would be using surplus balances as a set-off to debts due by them to the Centre, it was suggested that such reduction of their debts should be taken as part of the assistance proposed above. But because, as a result of this proposal, the Provinces had to bear certain interest charges which had hitherto fallen on the Centre, allowance was made for such charges before the actual assistance was counted.

In the case of Bengal, Bihar, Assam, the North-West Frontier Province and Orissa, it was convenient to combine the results of decentralization of balances and of debt cancellation. Accordingly in the case of these Provinces the entire existing debts[1] were taken over by the Government of India. The resulting net annual budget saving to the Provinces was counted against the assistance proposed to them. In the case of the Central Provinces a part of the debt was cancelled.

The following table shows the debt cancellations and the approximate net annual saving to each Province:

Bengal		33 lakhs
Bihar		22
Assam	All debt contracted with the Centre prior to April 1, 1936	15½
North-West Frontier Province		12
Orissa		9½
Central Provinces	Deficit debt as on March 31, 1936 and approximately two crores of pre-Reform debt	15

Export Duty on Jute

Since 1921 Bengal had repeatedly pointed out the injustice of the Meston Award. In September 1921 Lord (then Sir Malcolm) Hailey remitted Bengal's contribution of 63 lakhs to the Government of India. In the earlier discussions of the Round Table Conference the delegates from Bengal put forward a claim to a share of the proceeds from taxation on the export of jute. The Percy Committee (1932) did not favour

[1] At April 1, 1936

the claim as it would raise highly controversial questions of principle and would result in delaying *pro tanto* the remission of provincial contributions.

In chapter i we have pointed out the desirability of utilizing excise and export duties as balancing factors to correct inter-provincial inequalities and to introduce an element of greater elasticity in provincial revenues. It was on this principle that the White Paper[1] recommended that the Federal Legislature be empowered to assign to the Provinces and the States, in accordance with such schemes of distribution as it might determine, the whole or any part of the net revenue derived from some federal excises, and export duties. In the case, however, of export duties on jute or jute products, an assignment to the producing units was compulsory, and was to amount to at least 50 per cent of the net revenue derived from the duty.

Under the Government of India Act[2] not less than half of the net proceeds of the export duty on jute in each year was to be assigned to the Provinces or Federated States in which jute is grown in proportion to the respective amount of jute grown therein. Sir Otto Niemeyer recommended that the percentage under section 140 (2) of the Act should be increased to 62½ on the estimated gross yield of the duty in 1936–7. This resulted in the following additions to the resources of the Provinces:

Bengal	...	...	...	42 lakhs
Bihar	...	...	...	2½
Assam	...	...	...	2¼
Orissa	...	rather over		¼

The Federal Legislature is also empowered under the Government of India Act to assign to the Provinces the whole or any part of the net revenue derived from salt or other federal excises. This is a very important provision in the Act which can be utilized to fill the gaps and inequalities in the finances in the Provinces resulting from artificial provincial boundaries or other considerations.

The result of the help to the Provinces due to subventions, assistance due to debt cancellation, and the jute export duty is shown in the following table:

[1] December, 1931. [2] Section 140 (1).

Provinces	Total subvention recommended	Assistance due to debt cancellation	Assistance due to jute export duty
	in lakhs of rupees		
Bengal	75	33	42
Bihar	25	22	2½
Central Provinces ...	15	15	...
Assam	45	15½	2½
North-West Frontier Province	110	12	...
Orissa	50	9½	½
Sind	105	...	...
United Provinces ...	25	...	...

After allowing for the advantage derived from the above sources, Sir Otto recommended that the annual grants-in-aid under section 142 of the Act charged on Central revenues should be as follows:

United Provinces ...	25 lakhs	(for a fixed period of five years)
Assam ...	30	(in addition to the grant for the Assam Rifles)
North-West Frontier Province ...	100	(subject to reconsideration at the end of five years)
Orissa ...	40	(increased to 47 lakhs in the first year and to 43 lakhs in the 2nd, 3rd, 4th, and 5th years)
Sind ...	105	(increased to 110 lakhs in the first year; subject to reductions set out in par. 13 of the Report)

Summary of Various Forms of Assistance

The various forms of assistance already given or recommended in the Report are:

(i) Cash subventions.
(ii) Fifty per cent of the jute duty.
(iii) Additional 12½ per cent of the jute duty.
(iv) Benefits from debt adjustment.

TABLE IX

FINANCIAL ASSISTANCE ALREADY GIVEN, PROPOSED TO BE GIVEN OR WHICH WILL BE EFFECTIVE IMMEDIATELY ON INTRODUCTION OF NEW CONSTITUTION (IN LAKHS)

PROVINCES	Relief from separation of Sind and Orissa (par. 11)	Subvention proposed by Sir Otto Niemeyer (par. 24)	50 per cent share of duty on jute (based on figures in par. 22)	Extra 12½ per cent of duty on jute proposed by Sir Otto Niemeyer (par. 22)	Benefit from consolidation and reduction or cancellation of debt (par. 21 and Appendix III)	Total	SHARE FROM INCOME-TAX WHICH WILL ACCRUE IN FULL AFTER 10 YEARS ON ASSUMPTION THAT THE AMOUNT SURRENDERED BY GOVERNMENT WILL BE Rs. 6 CRORES		TOTAL OF COLUMNS (7) AND (9) IN LAKHS	PERCENTAGE OF TOTAL AMOUNT ALREADY SURRENDERED BY THE GOVERNMENT OF INDIA
							Percentage	Amount (lakhs)		
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	
Madras ...	20	...	...	...	26·2	46·2	15	90	136·2	9·6
Bombay ...	90	...	...	...	14·5	104·5	20	120	224·5	15·7
Bengal ...	...	...	168	42	33	243	20	120	363	25·6
U.P. ...	...	25[1]	...	...	12·7	37·7	15	90	127·7	9
Punjab ...	8	...	...	...	1·7	1·7	8	48	49·7	3·5
Bihar ...	...	...	10	2·5	22	42·5	10	60	102·5	7·2
C.P. ...	...	...	...	...	20·9	20·9	5	30	50·9	3·6
Assam ...	...	30	9	2·25	15·5	56·75	2	12	58·75	4·8
N.-W.F.P. ...	...	100[2]	...	...	12	112	1	6	118	8·3
Orissa ...	...	40[3]	1	0·25	9·5	50·75	2	12	62·75	4·4
Sind ...	...	105[4]	...	...	0·7	105·7	2	12	117·7	8·3
Total ...	118	300	188	47	168·7	821·7	100	600	1421·7	100

[1] For a period of five years.

[2] Subject to reconsideration at the end of five years.

[3] Additional Rs. 7 lakhs will be given in the first year, and Rs. 3 lakhs in each of the next four years.

[4] For a period of 10 years, to be reduced gradually thereafter (par. 13). In the first year an additional Rs. 5 lakhs to be given for the jail at Shikarpur.

(v) Prospective shares from income-tax.

(vi) Relief through the creation of new Provinces.

Table IX shows the assistance received by the Provinces by each of these methods.

Review of the Report

It is unnecessary to repeat once more that no financial arrangements in India can satisfy with complete justice the claims and counter-claims of the different Provinces. It is, however, interesting to note the views of the Provincial Governments as set out in the Explanatory Memorandum on the Draft Orders.[1]

The Madras Government contended that its comparatively sound financial position was due to its policy of financial orthodoxy followed in balancing the budgets, through adequate taxation, in the economic depression. With reference to the distribution of income-tax it pointed out that Bombay with a population of 18 millions is disproportionately benefited by the allocation of 20 per cent, as against Madras with a population of 44 millions and an allocation of 15 per cent.[2]

The Bombay Government recorded an emphatic protest in regard to the recommendations of the Report as it took no steps to correct the position in which the Presidency had been placed by reason of the inequities and inherent unsoundness of the Meston Settlement, including the falsification of the forecast of revenue made by the Meston Committee, the complete failure of the anticipations of the Percy Committee, and the cost of development schemes in Bombay City undertaken at the behest of the Secretary of State.[3]

The Bengal Government was not satisfied with the allocation of 62½ per cent of the proceeds of the jute export duty and reiterated its claim that the entire proceeds of the duty should be credited to the Provincial Government. It asserted that Bengal can never rest content under a fiscal system which aims at protecting, largely at her expense as a consumer, the products of other Provinces, while taxing her staple product for

[1] Cmd. 5181 (1936). [2] Letter dated May 5, 1936.
[3] Letter dated May 5, 1936.

the benefit of the Centre, in other words for the benefit of other Provinces.[1]

The United Provinces Government accepted the general conclusions of Sir Otto Niemeyer but pointed out the peculiar position of the Province on account of agrarian difficulties. For the last five years the Province had been giving an annual remission of Rs. 112 lakhs of land revenue which carried with it a remission of annual rent to tenants amounting to Rs. 4 crores. The Government suggested that the subvention should be raised to 40 lakhs (in place of 25) for each of the first three years and be fixed at 25 lakhs, as proposed in the Report, for the remaining two years.[2]

The Punjab Government made out a very strong case. It contended that the comparative stability of its revenues during the past three years was attributable to four main causes: (i) a high standard of taxation, (ii) drastic retrenchment, (iii) the strictest control over new expenditure, and (iv) favourable harvests.

Table IX points out the injustice to the Punjab. It is seen from the table that in the immediate relief amounting to 8,22 lakhs, the Punjab got 1·7 lakhs or one-fifth of one per cent. Out of the total relief which is estimated at 14,22 lakhs at the end of ten years, the Punjab will get 49·7 lakhs or 3·5 per cent.

Conclusion

Whether or not provincial autonomy will provide opportunities for the promotion of nation-building subjects will depend upon the co-operation between the Government and the governed. This will depend upon the nature of political parties. If the parties are based on communal considerations without giving considerable weight to social and economic questions, provincial autonomy will not solve India's social and economic problems. What is needed is to form political parties on broad economic principles and to stimulate public interest and co-operation in the schemes of rural development, education, sanitation and public health. The possibility of realizing some such work depends upon the co-operation of the two great communities in the service of Mother India. Financial solvency alone will not improve the condition of the hunger-stricken masses of India.

[1] Letter dated May 6, 1936.

[2] Letter dated May 6, 1936.

VI

THE FINANCIAL SYSTEM AND ADMINISTRATION

§1. *THE FINANCIAL SYSTEM UNDER THE REFORMS, 1919*

Scope of the Chapter

Having considered the fundamental aspects of the financial system introduced by the Reforms, we must now turn our thoughts to the new range of problems of financial administration. The reconstruction of financial administration was a necessary pre-requisite to the changed financial system. The increasing recognition of the need for efficiency and economy in provincial financial arrangements led to a consideration of budgetary reform. An account of the financial administration and budgetary changes introduced by the Reforms and provincial autonomy will be given in this chapter.

All other particulars of good government profit a state little unless its system of public finance is well designed, well understood, and well protected and maintained.[1] In the preceding chapters[2] we have attempted to explain the financial relations between the Central and Provincial Governments and the enlarged scope of provincial finance under the Reforms. In this chapter we shall study how with independent budgeting powers provincial finance entered a new phase in its development. That the financial administration was well protected and maintained and did not take liberties will be seen from the important position and functions performed by the finance department. In order that the public might understand the problems of financial policy, and the finance department might constantly be illuminated by the light of public opinion, the Finance Committee and the Public Accounts Committee were formed.

[1] See HILTON YOUNG, E., *The System of National Finance*, 1936, p. 1.

[2] See chs. ii, iii, iv and v.

The gradual process of financial devolution by which the Provincial Governments obtained a greater share and interest in the administration of the provincial revenues has been described in detail in chapters ii, iii and iv. With the introduction of dyarchy the control of the Provincial Legislatures in the administration of provincial finances increased considerably.

Before the Reforms the Provincial Governments had no independent budget of their own.[1] Their budget estimates had to be submitted to the Government of India for sanction, and the latter exercised stringent and meticulous control over provincial expenditure. As they could not impose any additional taxation or make any change in the existing system of revenue management or reduce any source of revenue or borrow money or control their balances, they had the responsibility of budgets *without full financial powers*.[2] With the introduction of the Reforms to co-ordinate the financial administration of the two aspects of the Government and to ensure that the rules of financial probity in collecting, keeping, and spending the revenues were properly adhered to, the institution of a separate provincial financial department became a supreme necessity. A careful study of the functions and constitutional position of the finance department, in view of its important position and the complaints about its over-riding powers in relation to the transferred subjects, is necessary.

Functions of the Finance Department[3]

Briefly, the finance department performed the following functions:

(i) It was in charge of the account relating to loans granted by the Provincial Government; and it advised on the financial aspect of all transactions relating to such loans.

(ii) It was responsible for the safety and proper employment of the Famine Relief Fund.

(iii) It examined and reported on all proposals for the increase or reduction of taxation.

(iv) It examined and reported on all proposals for borrowing by the Provincial Government. It was responsible for the

[1] See ch. iii. [2] See ch. ii. [3] See ch. iv.

raising of loans and for all matters relating to the service of loans.

(v) It framed proper financial rules for the guidance and maintenance of accounts for all departments.

(vi) It prepared the annual budget of the Provincial Government. Its advice on all schemes of new expenditure to be incorporated in the estimates was necessary. No new expenditure, which was not examined by it, could be included in the budget. It watched the state of the Provincial Government's balances.

(vii) It placed before the Committee on Public Accounts the annual Audit and Appropriation Reports and pointed out the irregularities in financial administration.

(viii) It advised departments responsible for the collection of revenue regarding the progress of collection and the methods of collection employed.

(ix) It had power to sanction, after grants were voted by the Legislative Council, any re-appropriation within a grant from one major, minor or subordinate head to another.[1]

Position of the Finance Department

These important services performed by the finance department gave it a most responsible position in the constitutional machinery of the Provincial Governments. It is often alleged that it had over-riding powers. As an example of its power it is said that it could decline to provide new expenditure which had not been submitted by it. Besides, in examining proposals of other departments, it was complained, it not only considered the financial point of view but also the *policy of the proposals.*[2] These criticisms however are not well-founded.

Indian financial administration is based on British financial practice. The British Treasury exercises even more stringent control than the Provincial Finance Department. According to the great Gladstonian tradition it is the function of the Chancellor of the Exchequer to act towards the estimate of

[1] See *Draft Rules under the Government of India Act 1919*, Cmd. 891 (1920), pp. 13–16.

[2] See *Reforms Enquiry Committee Report* (*Minority*), Cmd. 2360 (1925) pp. 165–6.

spending departments as *advocatus diaboli*. As guardian of the people's purse and as the man who will have to find the money, it is for him to see that no service is included that is not essential, and that every service that is included is provided for in the most economical manner.[1] This great tradition of the British Treasury makes the Chancellor of the Exchequer the watchdog of economy.

In the management of the limited financial resources of a Province it is highly important that the Finance Member, from the point of view of economy and efficiency, should adjudicate between the relative importance of the proposals of one department as compared with the proposals emanating from other departments. Each proposal must be considered not only on its own merits but also in relation to other objects of expenditure. As each half of the Government was provided with its share of resources, the examination of each item of expenditure before its sanction by the finance department was necessary for uniformity and efficiency in financial administration. The rule had great practical utility as it co-ordinated the activities of the reserved and transferred departments. It was in harmony with the spirit of the principle of the Joint Purse.

General allegations against the all-pervading nature of the finance department in shaping the policy of the transferred subjects are not true.[2] In case of disagreement on an expenditure proposal relating to a transferred subject the minister on his responsibility could over-rule the finance department, unless the finance department definitely required that the matter be referred to the Governor. The practical working of the Constitution proved that these fears were based on misapprehension. In fact, the control of the finance department was not only irksome to officers of the transferred departments but also to officers of reserved departments. 'The finance department was in fact in the nature of an expert body who was to watch the state of provincial finance and to ensure its solvency, economy

[1] See HILTON YOUNG, E., op. cit., pp. 22–3.

[2] The allegation that the transferred departments were starved is considered in ch. x. See also ch. iv.

and integrity. . . . It could only advise; it could not insist upon its advice being taken.'[1]

Criticism of the Finance Department

The finance department was a reserved subject under the control of a member of the Executive Council. The Finance Member was not only in charge of this department but also of large spending departments, e.g. general administration, land revenue, irrigation and other minor departments. This arrangement was objected to both on constitutional and on administrative grounds. The three principal objections to the arrangement were: first, the finance department, although it had to deal with both reserved and transferred subjects, was a reserved subject. As such, it was objected, it could not be impartial in its dealings with the two sides.

Secondly, as the Finance Member was not only in charge of finance but also of important spending departments, he, it was alleged, favoured his own spending departments at the expense of all others. Moreover he could not deal satisfactorily with the same case from both the administrative and financial points of view.

Finally, though the finance department had merely advisory powers, it was thought that it possessed powers of final decision in the administration of all departments.[2]

Theoretically, the above objections appear to some extent valid. The ideal arrangement of course would have been that the finance department should have been neither a reserved nor a transferred subject but should have had an independent position; and the Finance Member should not have been in charge of any of the spending departments. The above suggestions obviously would have involved extra expenditure. The United Provinces Government were of opinion that the arrangement in force, however objectionable in theory, worked satisfactorily in practice. Moreover, a reference to the figures on page 226 clearly proves that the transferred subjects and

[1] See APPADORAI, A., *Dyarchy in Practice* (Longmans) 1937, pp. 180–1.

[2] *See Indian Statutory Commission Report*, vol. IX, *Memorandum submitted by the United Provinces Government*, Appendix I, p. 595.

the subjects under the Home Member did not suffer as compared with those under the Finance Member.[1]

Working of the Joint Budget

The question is often put, did the principle of joint budget work efficiently and smoothly in practice? The answer to the question depends upon the relations of the ministers with the finance department. It is generally admitted that in the allocation of revenue between the transferred and reserved subjects there was not much difference between the ministers and the finance department. The transferred subjects were provided with as much money as was consistent with the financial position of the Province. Year by year the finance department has strained every nerve to provide the transferred departments with the maximum amount of money available and it has consistently cut down the allotments of the reserved departments to the minimum consistent with efficiency, and even sometimes below that minimum. When the campaign of retrenchment began in 1923–4 the pruning was entirely at the expense of the reserved departments.[2] The total expenditure on law and order (reserved department) and the principal transferred departments from 1921–2 to 1939–40, given in Tables XV and XVI affords the best proof that the reserved departments were not favoured at the expense of the transferred departments. The increase in expenditure in the principal transferred departments (1921–2—1936–7) was over 20 per cent, when the increase in the reserved departments was practically nil.[3]

Another proof of the harmonious relations between the two sides of the Government is furnished by the fact that in spite of the financial stringency through which the Provinces passed there was no occasion in any Province for the Governor to order the allocation of the revenues at his discretion. This shows that there was co-operation between the ministers and the finance department.

[1] See *Indian Statutory Commission Report*, vol. IX, p. 42.
[2] ibid., p. 45.
[3] See pp. 224 and 226.

Voted and Non-Voted Items

Along with the division of the subjects into reserved and transferred, the powers of the Legislative Council for the appropriation of provincial revenue were definitely laid down in the Act. Provisos (*a*) and (*b*) to section 72 D (2) of the Government of India Act empowered the Governor to authorize, in case of emergency, such expenditure as might be necessary for the safety or tranquillity of the Province, or for the carrying on of any department; and in the case of reserved subjects to restore an item rejected by the Council on a certificate that the expenditure provided by the demand was essential to the discharge of his responsibility for the subject.[1] Also the Council had no jurisdiction over the heads of expenditure enumerated in section 72 D (3) of the Act, namely:

(i) Contributions payable by the Local Government to the Governor-General in Council.

(ii) Interest and sinking fund charges on loans.

(iii) Expenditure of which the amount is prescribed by or under any law.

(iv) Salaries and pensions of persons appointed by or with the approval of His Majesty or by the Secretary of State in Council.

(v) Salaries of judges of the High Court of the Province and of the Advocate-General.

It was frequently complained in the Councils that the expenditure on non-voted items was too heavy and hence the powers of the Council regarding the sanction of expenditure were greatly restricted. A careful view of the non-votable expenditure would convince anybody that the major part of the non-votable expenditure was absolutely obligatory, which in any case the Council could not, if it had any respect for its own honesty and reputation, have refused to vote. The position is precisely the same in England, where although policy is made at the centre neither the Chancellor nor Parliament controls the whole of public expenditure.[2] The

[1] See ch. iii.

[2] Hicks, U. K., *The Finance of British Government* (Oxford University Press) 1938, p. 21.

expenditure on supply services needs the annual and recurring authorization of Parliament. The expenditure on the Consolidated Fund Services is established by permanent statutes; and these services include the charges on the National Debt, the King's Civil List, and a number of special salaries, annuities and pensions, including part of the expenses of the Courts of Justice. In the Provinces expenditure mentioned in section 72 D (3) is of the same nature as expenditure on the Consolidated Fund Services in England. As an example it may be mentioned that in 1922–3 in the United Provinces, out of the total provincial expenditure of Rs. 13,13 lakhs, Rs. 4,82 lakhs was non-votable. Out of the non-votable portions, Rs. 3,87 lakhs was in the nature of Consolidated Fund Service expenditure, so there was only a sum of Rs. 95 lakhs which the Council could have reduced or omitted, if it had all been votable.[1]

Standing Finance Committee

The Reforms, to offer greater opportunities to the Provincial Legislatures of influencing the financial policy of the Executive, established two committees, namely, the Finance Committee and the Public Accounts Committee. Corresponding to the British Estimates Committee, there was attached to most of the Provincial Legislatures the Standing Finance Committee whose principal functions were to scrutinize proposals for new expenditure, to advise on supplementary estimates, and to consider and initiate proposals for retrenchment and economy. When the schedules of new demands were ready, the Committee arranged the individual proposals in order of urgency, although the final decision rested with the Government. The Committee was presided over by the Finance Member and contained a majority of members elected by the Legislative Council.

The Standing Finance Committee enjoyed wider powers by convention and exercized a considerable influence in controlling and influencing the financial administration of the Provinces. In some Provinces the Committee was consulted on proposals for the imposition of additional taxation. In the Central

[1] See Speech of Sir Edward Blunt, *Proceedings of the United Provinces Legislative Council (Official)*, p. 309, vol. VII, March 8, 1922.

Provinces it advised the Government on matters of loans, while in Madras the distribution of surplus revenues between the transferred and reserved halves of the Government was largely determined by the Committee. The Committee served a useful purpose and proved to be a very valuable institution.[1]

The criticism against the all-pervading nature of the finance department, in view of the above functions of the Committee in harmoniously co-ordinating the interests of the two halves of the Government, loses much of its force.

Public Accounts Committee

The Public Accounts Committee is a statutory body and was constituted under the Government of India Act (1919). It had no prototype in pre-Reform days. Under rule 33 of the United Provinces Legislative Council Rules the Committee consisted of 8 members elected by the Legislative Council and 3 members nominated by the Governor. The Finance Member was the Chairman of the Committee.

The functions of the Committee, like the corresponding Committee of the House of Commons, are:

(i) To satisfy itself that the money voted by the Council has been spent within the scope of the demand granted by the Council.

(ii) To bring to the notice of the Council:

(*a*) every re-appropriation from one grant to another;

(*b*) every re-appropriation within a grant which is not made in accordance with the rules regulating the functions of the finance department or which has the effect of increasing the expenditure on an item the provision for which has been specifically reduced by a vote of the Council; and

(*c*) all expenditure which the finance department has requested be brought to the notice of the Council.[2]

The main function of the Committee was thus to see that the expenditure incurred during the year was in accordance with the original demand or with a supplementary demand voted by

[1] See Cmd. 3568 (1930), pp. 369–70.

[2] See *Appropriation Report on the Accounts of the Government of the United Provinces*, 1924–5, p. 96.

the Council. The Committee had to point out cases of irregularities or extravagance. But the Committee was not an executive body. It had no power to disallow any item or to issue an order even on the clearest evidence of extravagance or irregularities. It could only call attention to irregularities and record its findings and recommendations.

It is unfortunate that the Committee in the United Provinces in the beginning was a definite failure. It did not attract the most able members of the Council. As the personnel of the Committee was changed every year the members did not take sufficient interest in its work. With the change in the rules regarding election to the Committee which ensured some continuity of membership and the change in the attitude of the leading members of the Council, the Committee performed more useful functions in later years than when it was first established.

§ 2. *PROVINCIAL AUTONOMY, 1937*

Financial Procedure

The constitutional changes introduced by provincial autonomy have been described in chapter v. Provincial autonomy has also changed financial procedure in the Provinces. The basic principle of the procedure, which must always be the foundation of any sound system of public finance, is that no proposal for the imposition of taxation or for the appropriation of public revenues, nor any proposal affecting or imposing any charge upon those revenues, can be made without the sanction of the Executive. Under the Constitution (1937), estimates of expenditure embodied in the Annual Financial Statement are grouped into three categories:

(i) the sums required to meet expenditure described by this Act as expenditure *charged* upon the revenues of the Province;

(ii) the sums required to meet other expenditure proposed to be made from the revenues of the Province; and

(iii) the sums which the Governor has directed for inclusion in the Financial Statement as being necessary for the due discharge of any of his special responsibilities.

The expenditure charged on the revenues of each Province is as follows:

(*a*) The salary and allowances of the Governor and other expenditure relating to his office for which provision is required to be made by Order in Council;

(*b*) debt charges for which the Province is liable, including interest, sinking fund charges and redemption charges, and other expenditure relating to the raising of loans and the service and redemption of debt;

(*c*) the salaries and allowances of ministers, and of the Advocate-General;

(*d*) expenditure in respect of the salaries and allowances of judges of any High Court;

(*e*) expenditure connected with the administration of any areas which are for the time being 'excluded areas';

(*f*) any sums required to satisfy any judgement, decree or award of any court or arbitral tribunal;

(*g*) any other expenditure declared by the Act or any Act of the Provincial Legislature to be so charged.

The estimates of expenditure charged on the revenues of the Province [i] shall not be submitted to the vote of the Legislative Assembly. They are, however, open to discussion, except the salary and allowances of the Governor. The sums mentioned in (ii) and (iii) shall be submitted in the form of Demands for Grants to the Legislative Assembly, and the Legislative Assembly shall have power to assent, or refuse to assent, to any demand or to assent to a demand subject to a reduction of the amount specified in it. The Governor may restore any sum specified in (iii) if he thinks it desirable to do so.

Non-votable Heads of Expenditure

It will be observed that most of the heads of the expenditure charged on the revenues of a Province are analogous to payments which would in the United Kingdom be described as Consolidated Fund Charges and as such would not be voted annually by Parliament. The inclusion of ministers' salaries in the above list is justified in India. The English convention whereby a motion for a nominal reduction in the salary of a minister as a convenient method of criticizing a department or ventilating grievances has not fully established itself in India. On the contrary, Legislatures have misused their powers in such

a way as to deprive ministers of the whole of their salaries. The Act, however, provides opportunities for criticizing the Executive.

System of Demands for Grants

All proposals for appropriation other than those mentioned in (i) are submitted to the legislature in the form of Demands for Grants, and the Legislature has the right to assent, reduce, or to refuse assent to any demand, including those which the Governor has proposed as necessary for the fulfilment of his special responsibilities. Except in the last case (the Governor being empowered to restore any such grant if he thinks it desirable to do so) the decision of the Legislature is final; and it is this power in the matter of supply which will give the Legislature its real control over the Executive. It might be objected that the heads of expenditure which would not be subject to the vote of, but only open to discussion by, the Legislature are so extensive as materially to diminish the field of responsible Government in the Provinces. Most of the heads of expenditure enumerated above are not, as we have pointed out, even in the United Kingdom subject to an annual grant by Parliament. There is little substance, I think, in this objection.

Conclusions

From the foregoing brief account of the financial administration under dyarchy, some general conclusions may be drawn. Dyarchy was a bridge between autocracy and full responsible government.[1] Its success depended upon a number of factors, social, financial and political. From a financial point of view the control of the finance department was essential to co-ordinate the various aspects of financial administration. Theoretically this may not be justified, but from a practical point of view it was essential for the harmonious administration of the Government as a whole. With the transfer of greater responsibility in 1937 some of these objections have automatically disappeared. Provincial autonomy has abolished the distinction between Reserved and Transferred subjects, and the finance department is now under the charge of an Indian minister.

[1] See chs. iii and iv.

VII

LAND REVENUE

Plan of the following Chapters

The administrative and financial system introduced by the Reforms has been described in chapters iii, iv, v, and vi. In order to understand the financial position and policy of the Provinces and the effects of the policy on the life of the people, it is necessary to analyse the nature of provincial financial resources and expenditure. It is not possible to obtain (in a short space) a detailed idea of the financial position of each Province and of the changes in their budgetary position introduced from 1921 to 1939. Hence, by analysing the resources, expenditure and budgetary position of the United Provinces (which is more or less representative of other Provinces) it is intended to illustrate the general trend of provincial finance. With this object we first analyse the five main heads of revenue included in the provincial accounts, i.e. (i) Land Revenue; (ii) Irrigation; (iii) Forests; (iv) Excise and (v) Miscellaneous Taxes. Expenditure, since the Reforms, in the provincial accounts, is divided into two main heads: (1) Expenditure on reserved departments; and (2) Expenditure on transferred departments. Expenditure on reserved departments is given under four heads: (i) Police; (ii) General Administration; (iii) Justice and (iv) Jails. On the transferred side the main headings are (i) Education; (ii) Medical; (iii) Public Health; (iv) Agriculture; and (v) Industries.

In chapter vii land revenue will first be considered, followed by irrigation, forests and excise (ch. viii) and miscellaneous taxes (ch. ix). Chapter x will be devoted to a study of expenditure. A chronological account of the financial conditions and policy during the period, leading up to a summary of the general trend of financial development, will be given in chapter xi.

§1. *INTRODUCTORY*

No one item of revenue in India has aroused greater interest and criticism than the revenue derived from land. But studies on agrarian problems and policies have been surcharged with political controversies and have not taken into consideration the more important economic issues. A dispassionate examination of the subject, while pointing out the defects of land revenue policy, should also acknowledge the abuses of tenant law which have invariably enhanced the burden of the peasantry. It is thus that we can get a clear picture of the existing conditions of the peasantry and suggest remedies for an equitable distribution of the tax burden among the different sections of the agricultural classes.

The answer to the old controversy whether land revenue is a tax or rent depends upon the answer to the question whether the state or the landlord is the full proprietor of the soil—a subject which in itself is a matter of endless controversy.[1] The discussion is a profitless war of words,[2] and as Dr Anstey has observed, the answer would not suffice either to defend or condemn the system.[3] For whether the Government or the landlord is the full proprietor of the soil, any attempt to rack-rent the peasantry would produce the same unfortunate results on them. Hence a proper and a scientific study of the subject must consider the relative burden of land revenue on the peasantry under the permanent and temporary settlements, and zamindari and ryotwari settlements.

In studying the problems of land revenue in India it would be imprudent to generalize, for the principles and basis of land tax differ in different parts of the country. As the Taxation Enquiry Committee observed: 'In some parts the assessment is unalterable, while in others it is subject to periodical revision.

[1] The Indian Taxation Enquiry Committee (1924–5) were unable to record a unanimous and definite finding on the vexed question whether the land revenue is a tax or rent. They, however, rightly remarked, since land revenue forms a deduction from national dividend, it should be taken into consideration in dealing with the question of the incidence of taxation on the country as a whole (*Report*, pp. 66–7).

[2] BADEN-POWELL, B. H., *Land Revenue in British India* (1913) p. 49.

[3] ANSTEY, op. cit., p. 375.

In Bengal and some of the other zamindari tracts, there are numerous intermediaries, for instance, the *patnidar*, the *dir-patnidar*, the *sepatnidar* and others, between the Government and the cultivator,[1] while in the ryotwari areas of Bombay and Madras the cultivator deals direct with the Government.' Thus in examining the burden of land revenue in India we should always take into consideration the systems of land tenure, the type of settlement and the tenancy legislation of the Province.

§2. *REVISION OF LAND POLICY*

(i) Defects of Land Revenue

A Tax in rem

An examination of the burden of land revenue between the different sections of agricultural classes leads us to consider the defects of land revenue. Land tax in India is based either on gross produce, or net produce, or economic rent or the actual rent paid by the cultivating classes.[2]

The basis of the taxation of land has gradually undergone a change.[3] Formerly the land tax was a definite part of the estimated gross produce. Though the expenses of cultivation varied considerably for raising the same amount of produce, yet the same percentage, two-thirds, one-third or one-fourth, as the case might be, was demanded from each cultivator. No allowance under this system was made for the expenses of cultivation. Hence the ability of the individual taxpayer, as

[1] The word 'zamindar' is used here in a broad sense. It includes all intermediate tenure-holders, whether individual or co-sharers. 'Ryots' or 'cultivators' simply mean actual cultivators.

[2] The Indian Taxation Enquiry Committee, with reference to the basis of assessment, sum up the position thus: 'Except in British Baluchistan, the land revenue has ceased to represent a portion of the gross produce. In the United Provinces, the Punjab, and the Central Provinces, the Government demand is theoretically based on an economic rent, but actually takes many other factors into consideration. In the case of Madras and Burma, the assessment is based on the net produce, i.e., the gross produce minus the cost of cultivation. In Bombay, the rate of assessment is arrived at empirically with reference to the general economic considerations.'—*Report*, p. 60.

[3] For an excellent account of the modern principles of assessment see Sir Edward Blunt, *The I.C.S.* (1937) ch. viii.

judged by the productive powers of the soil, was not taken into consideration in fixing the tax.

The basis of assessment now is net assets and not gross produce. The substitution of net instead of gross produce, marked a 'step forward in the evolution of the idea of ability to pay'.[1] In ascertaining net assets the productive capacity of the soil, climate, agricultural conditions, and irrigation facilities among other factors, are always taken into consideration. The practice of course varies enormously from Province to Province. Assessment based on net assets always takes into consideration the varying expenses of cultivation.

But the one defect of an assessment based on net assets is that it regards land revenue as a tax *in rem* and not *in personam*. Taxation of the net product, says Professor Seligman, 'looked at the produce of the source of industry, rather than at the recipient of the earnings; it was a tax on things, rather than on persons; it was abstracted from the personal situation of the taxpayer'.[2]

The modern tendency has been to substitute taxes *in personam* for taxes *in rem*. It is now commonly recognized that taxes are ultimately paid by persons and not things. Inanimate objects like land, tea, sugar, etc., are incapable of paying taxes. The ultimate burden of taxing such objects must fall upon persons. This fundamental change of attitude to lay greater emphasis on human personality is clearly reflected in different tax systems. The adoption of the principle of progression; the differentiation between earned and unearned incomes; and the differential consumption taxes on necessaries and luxuries, are some of the devices to introduce a greater personal element in the tax system of a country.

The Indian land revenue system has failed to view the land tax from this changed angle of vision. The result has been that land revenue viewed as a system of taxation is not only not progressive, but actually tends in the opposite direction.[3] Since it is levied at a flat rate, it sometimes is a regressive tax.[4]

[1] SELIGMAN, op. cit., p. 14. [2] ibid.

[3] *Report of the Indian Taxation Enquiry Committee*, p. 77.

[4] At least under the Permanent Settlement.

It has created vast inequalities of tax burdens.[1] At one extreme are the big zamindars in the permanently settled areas who contribute a nominal part of their income, lawfully or unlawfully derived from the cultivators;[2] at the other end of the scale come the cultivators of uneconomic holdings who are impoverished under the heavy burden of rent and the illegal exactions of the zamindars. Meanwhile, the pressure of the rents on account of low production, excessive fragmentation of holdings and heavy indebtedness has been more keenly felt.[3]

An Element of Progression should be Introduced

From the above discussion one conclusion stands out prominently. If land revenue is to occupy its proper place in the system of national finance, it should contain an element of progression. The element of progression can only be applied when it is realized that land revenue in a tax *in personam*. With this change in conception the landlord will be the subject of the tax, while his income will be the object of the tax.

But the crucial question is, how can progression be introduced? In the varying land systems of the country, with differences in the basis of assessment, a direct introduction of the principle of progression is an extremely difficult matter. Hence, the best workable plan is to tackle the land revenue problem from two points of view. First, our object should be to lessen the burden, especially of rents, on small cultivators; and secondly an endeavour should be made to transfer a larger share of the burden of taxation to the broader shoulders of the landlords and the long chain of intermediate tenure-holders.

How is this to be achieved?[4] We should approach the problem directly and indirectly. The burden of the small-holder can be directly lightened by (i) reducing the percentage of land revenue from 40 to 25 per cent of the net assets in temporarily

[1] The absence of income-tax has further heightened the inequality of tax burdens. This question is discussed in pp. 156–60.

[2] The question of illegal exactions (*nazaranas*) is discussed in pp. 151–3.

[3] See ch. i for the size of the holdings.

[4] The recommendations in this chapter mainly apply to the zamindari areas of North India. Some of the instances given here are taken from the United Provinces.

settled parts of the country, and (ii) reducing the rentals of the cultivator by 25 per cent.[1] This loss in provincial revenues can be made up by the imposition of an income-tax on agricultural incomes and the introduction of death duties.[2]

Advantages of the Scheme

The above scheme possesses several practical and theoretical advantages. It would least disturb the existing tax machinery of the country. Any more radical suggestion would, first, cause an upheaval in the tax system of the country; secondly, it might not be proved practicable; and lastly, time alone can prove whether it is a better alternative to the existing system or not.

Secondly, the scheme would lighten the burden of small-holders. Thirdly, it would put an increased burden on those who are better able to pay. Finally, as we shall see later on, it would correct the unfair distribution of the tax burden between the landholders themselves and between landholders and other classes receiving income from non-agricultural sources.[3]

Should an Uneconomic Holding be Exempted from the Payment of Land Revenue or Rent?

Incidentally we may examine the proposal suggested by certain people for the entire exemption of the uneconomic holding from land revenue.[4] Such a proposal, attractive though it may appear, is full of difficulties. It would be difficult to decide the size of the economic holding. The size of the economic holding differs enormously from Province to Province and within the various districts of the same Province. It would be an extremely difficult task to record a unanimous and

[1] A reduction in the percentage of land revenue is essential before a reduction in the percentage of rentals.

[2] In the permanently settled areas the rates of the tax on agricultural incomes should be higher. The exemption limit should also be, as compared with temporarily settled areas, lower.

[3] See pp. 156–60.

[4] See *Indian Taxation Enquiry Committee Report*, p. 78. A better proposal would be to free uneconomic holdings from future enhancement of rent or revenue. For a discussion of this proposal, see *United Provinces Agricultural Debt Enquiry Committee Report* published in the *U.P. Gazette* dated Sept. 10, 1932.

definite finding as to what is the size of an economic holding for each area.[1] Secondly it seems probable that the great majority of cultivators possess uneconomic holdings. The United Provinces Banking Enquiry Committee made a detailed inquiry into the subject and concluded that 30 per cent of cultivators possess holdings which are definitely uneconomic; while 52 per cent possess holdings which are either just above the economic level or possess uneconomic holdings with a subsidiary occupation.[2] The exemption of the uneconomic holding would result in practically freeing 82 per cent of the cultivators from the payment of land revenue. This would naturally mean a huge loss of revenue. Thirdly, the exemption would put a premium on the further fractionalization of large-sized holdings. Lastly, it would create huge administrative difficulties, because the answer to the question as to what is an uneconomic holding 'is always a question of fact' and 'will vary according to the circumstances of each particular case'.[3] Thus any attempt to lighten the burden of the small-holder by the entire exemption of the uneconomic holding from the payment of land revenue is a measure of doubtful utility and might in some cases lead to undesirable consequences. For, judging from past experience, it appears that an increased spending power, unaccompanied by education and other safeguards, is either squandered or is swallowed up by an increase of population.

Perhaps a more desirable suggestion is to increase the present Government expenditure on improvements in rural areas. For such an expenditure would ultimately be more beneficial to the country as a whole, and to the masses in particular, than the type of expenditure that might be expected from land revenue remission or its drastic reduction.[4]

[1] See ch. i, pp. 13-14, for the difficulties in the definition of an economic holding.

[2] *United Provinces Banking Enquiry Committee Report*, Vol. I (1930), p. 99.

[3] ibid., p. 24.

[4] ANSTEY, op. cit., p. 377.

(ii) Abuse of Tenant Law

Illegal Exactions

Before we pass on to consider the proposals for increasing the burden on zamindars it is essential to examine the influence of the abuse of tenant law which creates an additional burden on the peasantry. Over-zealous critics of the land policy have seldom given adequate attention to this aspect of the problem. An examination of the condition of the peasantry in landlord-ridden Provinces will convince any fair-minded inquirer that their impoverished condition is to a large extent due to rack-renting (through various illegal devices) by the zamindars and the chain of inferior proprietors.[1]

With the conferment of definite legal rights by the British the economic status of the zamindar underwent a remarkable change. He lost touch with the actual cultivators and became an absentee landlord. Absentee landlordism has given rise to a host of intermediaries, varying in number, in a different part of the country. Such middlemen are eating up the meagre profit derived from small farming and lowering the legal status and the economic position of the actual tillers of the soil.[2] Through the practice of *nazaranas* or *awabs*, zamindars or intermediaries extort large sums of money from the peasantry, annually or on the renewal of a tenancy. Mr Jack, in his report on the settlement operations in Bakarganj, estimated that in one year the total amount collected as *awab* in that district amounted to no less than 20 lakhs of rupees, or more than the entire Government land revenue, and one-quarter of the entire rentals of the district. The practice is no less common in the United Provinces, where the talukdars and zamindars occupy a very strong position.

The levy of such illegal exactions has considerably increased the tax burden of the peasantry, though in the majority of cases the information may not see the light of day. Nor must it be forgotten that the burden of such illegal exactions is always

[1] The writer conducted an economic survey in a Cawnpore village. See *The Economic Survey of a Cawnpore Village* (Government Press, Allahabad) 1931. Some of the following remarks are based on personal experience.

[2] Mukerjee, R., *Land Problems of India* (Longmans) 1933, p. 90.

heavy on ordinary tenants who are already paying higher rents than stable tenants.

This is because the weaker the legal position of the tenant, the greater are the chances of his exploitation by the zamindars. The marked disparity in the rental demand between the stable tenants and ordinary tenants can be seen from the following table:[1]

INDEX NUMBER OF RENTAL DEMAND

Year	Stable Tenants	Ordinary Tenants
Average 1901–5	100	100
1906	104	106
1907	104	107
1908	105	108
1909	105	111
1910	106	112
1911	106	115
1912	106	116
1913	107	117
1914	108	119
1915	109	120
1916	111	121
1917	111	122
1918	111	125
1919	109	128
1920	113	133

[1] For the sake of comparison the whole body of the tenants in the United Provinces has been divided into two broad classes, the basis of division being differences in *legal status* upon which economic strength depends. *Stable tenants* in Agra include permanent tenure holders, fixed rate tenants, exproprietary tenants, occupancy tenants, and tenants of not less than 12 years' standing in 1333 *Fasli* (A.D. 1923–4) while in Oudh they include under-proprietary, exproprietary and occupancy tenants. The term *ordinary tenants* refers to statutory tenants, heirs of statutory tenants and non-occupancy tenants.

Statistics of rent refer to the agricultural years July to June and not to calendar years.

The table is taken from Bulletin No. 1 on 'Agricultural Prices in the United Provinces' issued by the Bureau of Statistics and Economic Research, United Provinces Government (1933). The author of the bulletin is Dr Raj Bahadur Gupta.

The period chosen as the base is the quinquennium 1901–5.

For the legal position of the various classes of the tenants see the United Provinces Tenancy Act (1939).

Year	Stable Tenants	Ordinary Tenants
1921	114	134
1922	115	137
1923	117	139
1924	118	142
1925	119	144
1926	120	146
1927	120	146
1928	120	165
1929	120	165
1930	121	166

From the above table it is apparent that the rents of the ordinary tenants had risen by 45 per cent more than those of the stable tenants. Unfortunately the very class which needs greater relief and protection has to bear the heavier burden of illegal exactions. How many of the well-wishers of the peasantry have given attention to this aspect of the problem?[1]

(iii) Provincial Inequalities Caused by Permanent Settlement

One of the most important problems of land revenue, over which there has been a huge controversy, and which has created inter-provincial inequalities and unfair distribution of tax burdens, is that of the Permanent Settlement. In a previous chapter[2] we have seen that Bengal made loud protests against the injustice of the Meston Settlement. It has often been pointed out by the Bengal Government that her financial difficulties, on account of the Permanent Settlement, are special, and hence that the Province needs favoured treatment.[3] The favoured treatment which Bengal has received from time to time from the Government of India raises the important question, is Bengal entitled to such treatment? Looked at from

[1] The recent United Provinces Tenancy Act (1939) has considerably enhanced the status of the peasantry.

[2] See ch. iv.

[3] In September 1921, the Bengal Legislative Council sent a deputation to the Viceroy of India and urged the abolition of its share of the provincial contributions. As a result, the Legislative Assembly remitted for a period of 3 years her annual contribution of 63 lakhs. Hence the Bengal Government paid only for *one* year her contribution under the Meston Scheme. See ch. iv.

the wider point of view of the country as a whole the problem of the Permanent Settlement is an all-India question. The revenues from the different Provinces make up the finances of the country as a whole. If Bengal or any other part of the country is not contributing its proper share to the country's finances a proportionately larger burden must fall upon the taxpayers of other Provinces.[1] It may be worth while to examine briefly the equity of the Permanent Settlement from this broader point of view.

The glaring injustice of the Permanent Settlement to the people of other Provinces is apparent from the following table:

INCOME FROM LAND REVENUE (THOUSANDS OF RUPEES)

PROVINCES	TOTAL PROVINCIAL REVENUE (AVERAGE 1925–35)	ORDER IN POINT OF PERCENTAGE	INCOME FROM LAND REVENUE (AVERAGE 1925–35)	PERCENTAGE OF LAND REVENUE TO TOTAL PROVINCIAL REVENUE	ORDER IN POINT OF PERCENTAGE
Madras ...	16,81,57·8	1	5,86,41·8	34·9	5
Bombay ...	14,77,01·7	2	4,66,85·6	31·6	7
United Provinces ...	12,00,76·8	3	6,33,55·4	52·8	2
Bengal ...	10,32,74·9	5	2,91,76·9	28·3	8
Burma ...	9,48,76·0	6	5,27,96·5	55·6	1
Central Provinces ...	4,89,32 9	8	2,25,66·4	46·1	3
Assam ...	2,50,75·3	9	1,14,84·1	45·8	4
Punjab ...	10,98,85·0	4	2,77,23·0	25·2	9
Bihar and Orissa	5,49,34·6	7	1,75,33·9	31·9	6

It is clear from the table that the income from land revenue in Bengal, in spite of its high fertility, comparative immunity from famine conditions, and the cultivation of money crops like

[1] The above assertion is justified when Bengal demands larger subventions from the Central revenues whilst it does not increase its own resources. See chs. iii, iv, and v.

jute and rice, is far less than that in other Provinces. The result has been, as Dr Mukerjee puts it, that the Permanent Settlement in Bengal, while benefiting the small minority of zamindars in the Presidency, has gravely prejudiced the people of the other provinces by leading to the imposition of a heavier burden.[1]

Apart from this broader question of inter-provincial inequalities, the Permanent Settlement has resulted in a colossal loss to the Government. While the total income from land revenue in other Provinces (despite reductions in the rate of assessment) has been continuously increasing, due to the progress of society and the bringing of larger areas under cultivation, the revenue demand of Bengal has stood at a rigid figure. 'According to the *Cess Report* of the Revenue Board the zamindars obtained Rs. 16 crores approximately from the ryots, of which the Government received less than Rs. 4 crores. At the time of the Permanent Settlement it was promised that out of the total collection the Government would receive 90 per cent, and the zamindars keep 10 per cent. According to this arrangement, the zamindars ought to have received Rs. 40 lakhs; instead they appropriated Rs. 12½ crores, while *the ryots are actually paying 30 times more*[2] to the zamindars than their share of land revenue. For a century and a half the zamindars have appropriated a total amount of Rs. 1,800 crores approximately.'[3]

Thus the Permanent Settlement has not only resulted in creating inter-provincial inequalities and a very heavy loss to the Government revenues, but it has created an unfair distribution of burdens as between zamindars and ryots and between zamindars and other classes of society. Unfortunately the greatest mistake in the terms of the Permanent Settlement was that while the revenue demand of the zamindar was taken to be fixed, the rents of the ryots were left at the mercy of competitive forces. The most undesirable consequence of this has been that the burden of the peasantry, without a corresponding burden on the zamindar class, was heavily increased. The vast disparity between the incidence of rent and revenue in

[1] MUKERJEE, op. cit., p. 305.

[2] The italics are mine.

[3] Quoted in MUKERJEE, op. cit., pp. 305–6.

some of the districts of Bengal can be seen from the following table:[1]

District	Incidence of rent per acre paid by tenant	Incidence of land revenue per acre paid by zamindar[2]
	Rs. A. P.	Rs. A. P.
Dacca	2 13 1	0 5 0
Mymensingh	3 8 4	0 3 8
Faridpur	2 9 2	0 8 6
Bakarganj	4 8 10	0 8 6
Tipperah	3 2 2	0 7 9
Noakhali	4 4 5	0 8 6
Chittagong	5 0 0	2 14 2
Rajshahi...	3 3 0	0 10 0
Midnapur	3 15 5	0 12 0
Jessore	2 7 5	0 6 5

(iv) Taxation of Agricultural Incomes

Having considered how the burden of the peasantry could be lightened, we may now suggest methods of increasing the contributions of the landlords. The most important gap in the financial arrangements in the Reforms period (1919–37) was the exemption of agricultural incomes from income-tax. An attempt to tax agricultural incomes has always aroused bitter controversies in the past and raised issues economic and non-economic. As such agricultural incomes even to this day are exempt from income-tax, it is desirable to study the subject under three heads:

(i) What are the reasons for the exemption?

(ii) What are the theoretical grounds which necessitate the levy of a tax?

(iii) What are the advantages of taxing agricultural incomes?

The reasons for exempting agricultural incomes from

[1] The disparity between the incidence of rent and revenue would be considerably enhanced if the various illegal exactions (e g. *awabs*, *salami*, etc.) exacted by the zamindars were also taken into consideration. For such illegal exactions merely represent *concealed rentals* and considerably enhance the burden of the peasantry. See the remarks of Mr Jack quoted on p. 151.

[2] See Mukerjee, op. cit., p. 307.

income-tax are based on two grounds. Firstly in the case of the permanently settled areas it is alleged that the levy of a tax would amount to a violation of the terms of the Permanent Settlement.[1] Secondly, it is said that as the income from land pays land revenue a further imposition of income-tax would amount to double taxation.

The plea that the taxation of agricultural incomes in Bengal would mean a breach of faith is baseless. In 1860, when the income-tax was for the first time imposed in India, incomes from agriculture were included in it. The Finance Member, Mr James Wilson, made it clear that the incomes from the permanently settled lands could claim no special exemption. He said, 'I hold him (the zamindar) to be exempt from any special charge upon his land, but to be liable to any general tax that applies to all others'.[2] Thus incomes from agriculture were taxed from 1860 to 1865 and again from 1869 to 1873. Moreover, a study of the Permanent Settlement Regulations clearly shows that it was never the intention of Lord Cornwallis to exempt the landlords from all future liabilities *arising from whatever cause*.[3] The controversy would be set at rest if once it is realized that income-tax on agricultural incomes from the *permanently settled lands is not an exclusive tax on such incomes alone* but is a common tax for all incomes derived from whatever source. It is a wholly different public demand based on entirely different principles and is irrespective of the claims and privileges of a certain class of people.

The claim for exemption on the basis of double taxation is

[1] See the written evidence of the East Bengal Landholders' Association, Dacca, before the Taxation Enquiry Committee. *Report*, Vol. V, p. 549.

[2] *Proceedings of the Council of the Governor-General*, February 18, 1860 (India Office Library). 'The Government have given their most attentive consideration to this claim of exemption, and I must say, the more I have looked into it, the more I am convinced that a more illusive claim could not be set up.' See *Financial Statement*, 1860–1, Speech of Mr James Wilson, Finance Member, February 18, 1860, p. 25.

[3] See Regulation I of 1793. Various compilations of the East India Company's Regulations were made. I have used *Bengal Regulations*, prepared by the Court of Directors of the East India Company by Richard Clarke, I.C.S. (1854). Printed by I. J. H. Cox, Lincoln's-Inn Fields (London).

equally groundless. Land in most countries is subject to four different taxes:

(i) A flat rate on capital or annual value.
(ii) An income-tax on incomes derived from land.
(iii) A death duty.
(iv) Local rates.[1]

In India land is subject only to two taxes: (i) Land Revenue and (ii) Local rates (cesses). In permanently settled areas land is very lightly taxed.[2] Under temporary settlements there has been a progressive reduction in the percentage of land revenue to net assets. In the beginning the landlords were given only a small portion of the rents collected by them, i.e. not more than 10 per cent. Regulation VII of 1822 fixed the State share at 83 per cent and Regulation IX of 1833 at 66 per cent of rental values, while the Saharanpur Rules of 1855 reduced it to 50 per cent.[3] The percentage has been further reduced in the United Provinces, where the amount that may be taken as land revenue is limited to not less than 30 and not more than 40 per cent of the net assets of the land.[4]

The theoretical cases for the imposition of a tax on agricultural incomes rests on very strong grounds. With the differentiations in the sources for different forms of earnings, the test of an individual's ability has undergone a change. An individual's relative ability to pay taxes now does not depend merely upon the sacrifice involved in parting with a certain amount of income but also upon the ease or difficulty with which he produces his income. Thus the greater the relative ease with which he produces his income the higher is his capacity to pay taxes.

An individual's power of acquisition of income usually

[1] Thus in England under Schedules A and B incomes from the *ownership* or the *occupation* of lands are included for the purposes of assessment of income-tax. Income-tax assessed under Schedule A is sometimes called Landlord's Property Tax. Schedule B is referred to as Farmer's Tax. See NEWPORT and STAPLES, *Income Tax Law and Practice*, 1930, p. 46.

[2] The landlords realize about 16½ crores from the ryots under permanent settlement of which the Government receives only about Rs. 4 crores.

[3] See my article on 'Principles of Assessment' in the *Indian Journal of Economics*, November 1935.

[4] See the United Provinces Land Revenue (Amendment) Act of 1929.

depends upon his privileges or opportunities. It is these privileges or opportunities which give rise to the principle of discrimination in taxation.

Hence it is now commonly recognized that Rs. 100 from labour cannot bear taxation as well as Rs. 100 from land or capital, because in the former case the worker has to make allowance for unemployment, sickness, old age and his dependents. This discrimination is based upon the common distinction between earned and unearned incomes. It considers the source of income. In one case the income depends upon the personal efforts of the worker and stops when the worker stops work. In the other case the receipt of the income does not depend upon the worker. It is a flow which passes from one generation to another. Thus on theoretical grounds incomes from agriculture partake of the characteristics of unearned incomes and contain a larger taxable element.[1]

In India agricultural incomes instead of being taxed at a higher rate are entirely exempt. This is due to political considerations. The landlords wield immense influence in the body politic of the country. Whenever an attempt is made to tax agricultural incomes a hostile opposition comes from vested interests. An excellent illustration of this is found in the Indian Income-Tax Bill of 1918. Section 4 of the Draft Bill proposed that agricultural incomes should be taken into account in determining the rate at which the income-tax was to be levied on incomes derived from other sources. This proposal was voted down in the Legislative Council by 30 votes to 25.[2] This proposal would not have taxed agricultural incomes, but it would have increased the rate of tax of those persons who were receiving incomes from agricultural and non-agricultural sources.

The advantages of taxing such incomes are obvious. It would result in a better distribution of tax burdens between different classes, agricultural and non-agricultural. It would minimize the inequality of tax burdens between the cultivating classes and landlords. Apart from correcting the present

[1] See Appendix I.

[2] See *Proceedings of the Imperial Legislative Council*, March 14, 1918.

maladjusted tax burdens, it would strengthen the finances of the Government of India. The weak financial position of the Government of India during the early years of the Reforms was partly responsible for the delay in the abolition of the provincial contributions.[1] The financial stringency of the Provinces was largely due to the provincial contributions. Thus some of the troubles in the working of the Reforms would have been mitigated if bold steps had been taken to tax agricultural incomes from the beginning of the Reforms. It is regrettable that in spite of the weighty arguments in favour of taxing such incomes the Government was shy in taking measures to remove this injustice.

The revision of the terms of the Permanent Settlement is a very difficult matter. It has often been suggested that the Permanent Settlement should be abolished. There is no reason, as Dr Anstey has pointed out, why a representative Government should continue to honour a bargain (i.e. the Permanent Settlement) made at the end of the eighteenth century between the Bengal (and some Madras) zamindars and the East India Company.[2] There is no question of a breach of faith, for after the lapse of a century and a quarter the original contract based on loyalty in troublous times has lost much of its meaning.[3]

Since the abolition of the Permanent Settlement would take a long time, as an immediate measure in permanently settled areas it may be suggested that agricultural incomes should be taxed at a higher rate (say 25 per cent more than the rates applicable to incomes from non-agricultural sources). The exemption limit for income-tax should also be put at a lower figure, say Rs. 1,000. This proposal is not incompatible with provincial interests, for under India's new Constitution (1937) taxes on agricultural incomes would go to provincial revenues.[4]

[1] See ch. iv. [2] ANSTEY, op. cit., p. 378.

[3] See my article on 'Early Revenue History of Agra Province', *Indian Journal of Economics*, July 1934.

[4] The Government of India Act 1935, Provincial Legislative List, Clause 41. See Appendix II.

§ 3. *CONCLUSIONS*

Having considered the important defects of the land revenue system and the possible lines of reform, in conclusion some general observations may be made, to show that the revenue system which fitted in with the economic and political tendencies of the nineteenth century is not in harmony with the present economic situation.

The first half of the nineteenth century was a period of conquest and consolidation of British power. The main object of the East India Company was the realization of a large amount of revenue necessary for the wars in which the Company was engaged. There was little opportunity in such a disturbed period to base the land revenue system on sound theoretical principles. During the second half of the nineteenth century, with the development of means of transportation and communication, the economic unification of the country had begun. It was in this period that all the work of survey and settlement was completed and the land revenue demand was placed on principles which, even today with slight modifications, form the basis of land assessment. Lord Curzon's famous Resolution of 1902 is a landmark in the history of land revenue policy.[1] It was an emphatic assertion of the success of the land revenue policy. However, it did not advocate any fundamental change in the principles of assessment.

With the rise and establishment of British rule a very important change appeared in the fiscal system of the country. Under Mogul rule the policy of tax-exemptions was a part of the political and fiscal system of the country. In return for political support the nobility was freed from tax payments. With the consolidation of the British power these political privileges were abolished. The abolition of these privileges marked the emergence of two important principles of taxation: *the universality and the uniformity of taxation.*

The first principle means that no person who has an income from land may escape taxation; the second, that all those who enjoy similar economic privileges from land should be subjected

[1] *Government Resolution* [*East India*] *on Land Revenue.* Cmd. 1089 (1902). Government Press, Calcutta).

to the same fiscal treatment. Proportional taxation, which taxes wealth objectively, that is, it taxes 'objects' and not 'persons', was the most convenient way to put these principles in the land policy of the country. Herein lies the origin of treating land revenue as a tax *in rem*.

It should not be inferred that this feature of land taxation was peculiar to India. Before the French Revolution the French nobility was exempt from the payment of land taxes and the greater burden of taxation was on the poor peasantry. With the emergence of the third estate after the French Revolution, in proportional taxation the poor and middle classes found a weapon to transfer the tax burden to the wealthier classes. Proportional taxation is eminently suited to abolish class privileges. It was this objective, non-personal character of the proportional system, observed Professor de Viti, that led to its being carried into effect by the men of the Revolution, who wished, above all else, to protect themselves against the danger of a return to those privileges.[1]

The land policy of the nineteenth century, however, now needs a revision under changed economic conditions. Lord Curzon's Viceroyalty (1899–1905) marks the end of an old economic era and the beginning of a new. The new economic policy, based on science and efficiency, introduced by him, demands a conscious and constructive economic development of the country. Proportional taxation with its objective basis is not in harmony with the changed economic policy. The recent agricultural policy of the Government, especially in the field of irrigation, scientific research and co-operation, has resulted in a new outlook with regard to the duty of the Government towards the cultivators. The aim of tenancy legislation throughout India has been to lighten the burden of the peasants and to save them from the vexatious exactions of the landlords. But all these measures, good in themselves, have merely patched the old machine of the nineteenth century. For neither scientific agriculture nor co-operation can improve the condition of the peasantry unless rental burdens are lightened as well.

The orientation of the new economic policy demands the

[1] De Viti, op. cit., p. 7.

introduction of the principle of progressive taxation in the land policy. Methods of introducing such principles have been outlined in the foregoing pages. Such a change in policy would rehabilitate the finances of the country and remove the oft-quoted accusation that the cultivators are groaning under the heavy weight of rental payments. India is not overtaxed in comparison with other countries. The defect of the land revenue and rental system lies, not in its pressure of total taxation, but in its maldistributed tax burdens. Lastly, 'more important than the reduction of taxation or of the land revenue is the need to extend protection against rack-rents'.[1]

[1] ANSTEY, op. cit., p. 177.

VIII

IRRIGATION, FORESTS AND EXCISE

§1. *IRRIGATION*

Irrigation under the Reforms

We have already noticed in a previous chapter that with the introduction of the 1919 Reforms irrigation became a provincial reserved subject.[1] The Reforms delegated enhanced financial powers to the Provincial Governments. Only those works estimated to cost over Rs. 50 lakhs had to be referred to the Government of India for submission to the Secretary of State.[2] Another important change since 1921 has been in the classification and financing of Government irrigation works. Up to 1921 canals were classified into three classes: productive, protective and minor works. Loans could only be raised for productive works which were expected to yield a fair return on capital expenditure within ten years of their completion. Protective and minor works were financed from the Famine Relief and Insurance Fund or from local finances. The former were designed to protect against local famines and increase the value of the crops, whilst minor works were those taken over by the Government from private enterprise. After 1921 this cumbersome classification was abandoned and all works are now classified as either productive or unproductive, without reference to the source from which the works are financed. All works can now be financed from loans. The former include those which are expected within ten years of their completion to produce sufficient revenue to cover their working expenses and the interest charges on their capital cost.[3]

[1] See ch. iii.

[2] See *The Moral and Material Progress of India, 1924–5*, p. 198 (Government of India Press, Delhi). See also ch. iii.

[3] *The Moral and Material Progress of India, 1924–5*, pp. 198–9.

Revenue from Irrigation

The varying importance of irrigation in different Provinces is shown in the following table:

Provinces	Total provincial revenue, average 1925–35	Net income from irrigation, average 1925–35	Percentage of irrigation revenue to total provincial revenue
	(in thousands of rupees)		
Madras	16,81,57·8	1,69,16·0	10·2
Bombay	14,77,01·7	49,99·8	3·38
Bengal	10,32,74·9	— 1,72·3	— 0·017
United Provinces ...	12,00,76·8	1,06,21·2	8·85
Burma	9,48,76·0	30,74·5	3·24
Central Provinces ...	4,89,32·9	73·1	0·15
Assam	2,50,75·3	...	...
Punjab	10,98,85·0	3,90,86·0	35·59
Bihar and Orissa ...	5,49,34·6	21,58·3	3·93

Nature of Irrigation Finance

A great deal of controversy has raged over the question as to whether in the revenue derived from irrigation there is an element of taxation or not. The Indian Taxation Enquiry Committee (1924–5) observed that the case of irrigation is different from that of the railways and the post office inasmuch as those services are of benefit to the community as a whole, whereas in the case of irrigation the benefit provided by the use of the credit of the general taxpayer accrues to the holders of certain particular lands.[1] The Committee were divided in their opinion as to whether the charge for water contains an element of taxation or not. Professor K. T. Shah maintains that it is impossible not to regard the whole of the irrigation revenue of the Government in India as essentially in the nature of a tax,[2] because firstly, the State charges a monopolist's price and

[1] *Report of the Indian Taxation Enquiry Committee*, p. 11.

[2] Shah, K. T., *Sixty Years of Indian Finance* (Taraporevala) 2nd edition, 1927, p. 319.

secondly, the charge is not just equal to the cost of the service rendered.

Both of the views stated above are incorrect as they have failed to realize the true value of irrigation works and consequently the nature of irrigation finance which should be judged in this light. As long ago as 1880 the Indian Famine Commission laid down that it would be a great error to rest the value of irrigation works on their direct revenue alone.[1] In considering the nature of irrigation revenue its direct and indirect value should both be taken into consideration. In years of drought the protective works render great help by saving human life, by preventing wasteful expenditure which would otherwise be required for costly measures of relief, and by avoiding loss of revenue through remission. In years of average rainfall they increase the wealth of the country by increasing the out-turn of crops and by enabling more valuable commercial crops to be grown. As Professor Knowles has put it: 'The irrigation works have made for security of life, they have increased the yields and the value of the land and revenue derived from it. They lessened the cost of famine relief, and have helped to civilize whole regions.'[2]

Apart from the direct and indirect effects of irrigation, the 'reproductive' influences of irrigation, from a wider financial point of view, should not be overlooked. Expenditure on irrigation is 'reproductive' in a wide sense as 'it increases the national income of the country as a whole by more than its annual cost'. Moreover, as 'it increases the incomes of the citizens, it thereby

[1] *Report of the Indian Famine Commission*, Part II, Cmd. 2735 (1880), p. 152.

[2] KNOWLES, L. C. A., *Economic Development of the British Overseas Empire* (Routledge) 1924, p. 370. It may be mentioned here that there are rigid natural limits to the extension of irrigation. Although irrigation increases the certainty of water-supply, an indefinite extension of irrigation results in (i) water-logging of the soil; (ii) the increase of malaria; (iii) an increase of *usar*- or *reh*-covered tracts; (iv) reduction of the level of subsoil water; and (v) exhausts the water-supply of the river which could have been utilized elsewhere. Hence during recent years 'area irrigated' has not increased *in proportion* to the area that is said to be irrigated by new works. Naturally, in most cases the most profitable works have already been constructed and a further extension of irrigation should be made only after careful examination of local conditions.

raises the yield of any given rate of tax, and thus contributes indirectly to the Government's revenue'.[1]

The 'reproductive' influences of 'productive' (and also of 'protective') works make it clear that the Taxation Enquiry Committee were beside the mark in their statement that while the railways and post office benefit the country as a whole, irrigation benefits only the holders of particular lands.

The irrigation charges and revenue of the Government vary according to the 'class of the work'.[2] As noted previously, 'protective' works are constructed not with a view to earn profits but to save the country from the calamity of famines. The price charged for water supplied from such works is not based on commercial principles. In 1935–6 while the gain from 'productive' works was 7·61 per cent, the yield from 'protective' works was only 1·08 per cent.[3] The Government thus subsidizes such works for reasons of general social considerations and consumers are charged less than cost. There is no taxation in this case.

The correct view for the purpose of theoretical treatment is to classify the irrigation revenue under the category of fee. Broadly speaking, the services performed by the State may be divided into two groups: special public services and general public services.[4] In the first group are included the post office, the telephone, the telegraph, the railways and the irrigation system of the country. The second group includes services like the defence of the country and the administration of justice. As the supply of the former group of services is capable of sale in units according to the needs of each citizen an exchange

[1] BENHAM, op. cit.

[2] A possible objection to the above analysis may be taken. It may be said that the revenue from 'irrigation' as a whole should be treated. It should not be split into two parts: (i) revenue from productive works and (ii) revenue from protective works. But since the *objects* and the *methods of finance* of the two classes of works are entirely different, the writer is justified in treating the revenue derived from the two classes of works separately. Moreover, the Provincial Governments keep *separate* accounts for each class of work and the results of each class are judged separately.

[3] See *Triennial Review of Irrigation, 1933–6* (issued 1938).

[4] A. DE VITI DE MARCO, op. cit., p. 78. For the Theory of Fee the writer is indebted to Professor de Viti; see Appendix I.

relationship between the State as producer and an individual as consumer arises. This exchange-relationship results in the phenomenon in public finance of what Professor de Viti calls a *public price*—i.e. 'the price of a public service'.[1] This price is called a fee.

The State in the production of these services finds itself in the position of a monopolist. The price-policy followed by the State, however, is based on different principles and considerations from those of a private monopolist. A private monopolist, irrespective of the interests of consumers, tries to fix the price at the point which will give him the maximum net revenue. In State production the interests of producers and consumers are identical. 'Indeed, the State carries the concept of such personal identity to its completion, because *all* citizens are at the same time producers and consumers, and one cannot conceive of consumption of public goods outside of the State.'[2] Hence in determining the public price (fee) the State keeps before it two principles:

(i) The public price must equal or must gravitate toward cost of production.

(ii) The fee is also a *potential monopoly price*.[3]

The second condition may appear to be contradictory to the first, but it is not. It simply means that in distributing the aggregate expenses of production between the different consumers the State may follow a policy of discrimination in demanding a different price from different consumers for the same unit of the commodity. For example, in distributing water charges the Government charges different rates to different consumers, irrespective of the cost of production of water supply.

It sometimes happens that the Government fixes the price of a service at a point which results in a net profit to the Government. This represents taxation. Often the Government makes a profit in the production of a part of the supply which pays for another part which is run at a loss. The protective canals may be compared with the strategic railways which are run at a loss which is made up from the earnings of the commercial lines of the country. Productive works pay for protective

[1] De Viti, op. cit., p. 81. [2] ibid., p. 81. [3] ibid., p. 81.

works. Hence, while there is a tax in one case there is a subsidy in another.

It may be mentioned here that the profits (representing taxation) earned in the case of productive works are not necessarily wrong. The productivity of land in canal-irrigated areas is largely dependent upon irrigation works. Where irrigation has turned deserts into flourishing cornlands the State has a right to earn profits. Irrigation charges and revenue justify taxation, 'because it is *not what is taken, but what is left*, which determines whether the cultivator is justly done by'.[1] It can hardly be asserted by even a carping critic of irrigation finance that the charges are oppressive as they are paid out of the incomes created by the labour of the cultivator.

Moreover, as the profits are used for the provision of 'general public services' they are not to be deplored, as they lower the tax burden of the country.

Finally, it is arguable that even under private enterprise there would be a partial monopoly, and that the monopoly price might well be higher than at present. The number of irrigation works likely to yield a profit is limited, and it may well be that even though existing works yield a higher rate of profit than the prevailing rate of return to enterprise, competition would *not* bring about increased construction. Indeed experience seems to show that private enterprise would not have resulted in the construction of so many irrigation works as have actually been built up by the State.

The Basis for Water Charges

The basis for water charges differs in different Provinces. In Sind, where the land will practically yield nothing without the help of irrigation, the charges for water are included in the land-revenue assessment. Nine-tenths of the total land revenue is due to irrigation and is credited in the accounts as irrigation revenue. In parts of Bombay and Madras a differential rate is charged in the assessment of land revenue for irrigated and non-irrigated lands. Wet lands are assessed at a higher rate than

[1] MACDONALD, J. RAMSAY, *The Government of India* (Swarthmore Press) 1919, pp. 143–4.

dry lands, the charges for water being included in land revenue. Similarly, in the United Provinces wet lands using canal water pay a higher rate of land revenue than dry lands.[1]

Besides, the rates vary according to the nature of the crop and the nature of the supply. For example, in the United Provinces in 1923 (when the rates were revised) the rates for some of the crops were put as follows:[2]

	Rs.	A.	P.	
Sugar-cane	12	0	0	for Flow
do	4	0	0	for Lift
Wheat	5	0	0	
Barley	2	8	0	
Other kharif crops	3	0	0	for Flow
do	1	8	0	for Lift

Conclusion

Three important points remain to be considered: (i) the basis on which the rates should be fixed, (ii) the division of the burden between the parties which benefit as a result of irrigation and (iii) the period for which the rates should be current.

The basis on which the rates are fixed should vary with the class of work. In the case of productive works the Government of India observed: 'The introduction into a tract of irrigation at the expense of the State increases the produce of cultivation, and the Government as representing the tax-payer is entitled to a portion of that increase, (i) as the owner of the water which it has brought to the fields at great cost and then sells to the cultivators, and (ii) as the sovereign landlord, entitled as such to an enhancement of land revenue in proportion to the enhancement in the proprietary share of the produce. The fixing of the price for the water is of the nature of a commercial transaction and should be regulated mainly by the price the cultivator is willing to pay for it.' In 1922 they definitely laid down that 'the declared policy of the past has been that the full value of the water distributed by the

[1] See the *Report of the Indian Irrigation Commission, 1901–3*, Cmd. 1951 (1903) ch. ix, for an account of the methods of charging water. See also *Indian Taxation Enquiry Committee Report*, ch. v.

[2] See *Proceedings of the United Provinces Legislative Council*, February 2, 1923, p. 238, vol. XII, 1923 (India Office Library).

Government works should be recovered for the taxpayer, by whom the capital is provided, so far as is consistent with the maintenance of the demand for water'.[1] In the case of protective works, for social reasons the full value of water is not recovered.

In determining the rates for a particular locality, cost, quantity, area, crops and prices should all be taken into consideration. Costs would influence the fixation of minimum rates. Except in the case of protective works, water rates must at least cover the working expenses and the interest charges on capital outlay. A charge by quantity would be ideal in India where the full value of water is not realized and there is always an enormous wastage of water. But administrative experience points out that except in the case of large landholders charge by quantity is not feasible, as the majority of holdings are fragmented and are very small. An approximation to charging by quantity can be reached by supplying water for each area for certain fixed times. Charges based on crops lead to discrimination in rates. Usually charges for valuable crops are fixed at a higher rate. Finally, as water forms an important element in the expenses of production of crops, it is desirable to vary irrigation rates with variations in prices. Thus, in periods of rising prices the rates should be increased. Similarly, in periods of agricultural depression an all-round reduction of rates would afford relief to cultivators. This suggests the necessity for revising the rates at more frequent intervals than is done at present.

Secondly, the irrigation policy of the Government should be looked at from a different point of view. The security afforded by irrigation affects differently the interests of the three classes, namely, the general taxpayers, the landlords and the cultivators. The general taxpayer is benefited both directly and indirectly —directly, because with the increased prosperity of the agricultural classes the revenue from land and the profits from land are increased. Such gains strengthen the finances of the Government. The protection afforded by irrigation decreases the wasteful expenditure on famine relief which was a heavy drain on the finances of the country. The landlords benefit through

[1] Quoted in *Taxation Enquiry Committee Report*, pp. 110–11.

a rise in the value of land and secure an enhanced payment of rentals. The cultivators through the increased crop-security do not depend upon the vagaries of the monsoon rainfall and benefit in the greater productivity of the land.

All the three parties, benefiting in different degrees through a wise irrigation policy, should contribute their proportion towards the finances of the country. The general taxpayer already shares the burden, because most of the protective works were originally constructed (before 1921) out of the current revenues. In cases where they have been constructed out of borrowed funds the yield on them is distinctly lower than the interest paid or than what could have been earned elsewhere and thus the revenue of the Government is diminished to that extent.

The cultivators in the case of protective works receive a subsidy. In productive works, as the charges contain an element of monopoly profit, the cultivator pays more than the expenses of production. The landlords, in spite of the benefit, it appears, are escaping their burden. Perhaps the best way to tax these 'capital gains' and increased secured income is to levy a tax on agricultural incomes and introduce death duties. The first proposal we have considered in detail in chapter vii; the second we consider in chapter ix.

Finally, the irrigation rates should be revised at more frequent intervals. The history of the irrigation rates in the United Provinces shows that the same rates remained in force for a very long period. The first general revision of the rates was made in 1878–9.[1] After that year, besides minor changes, no change was made till 1905–6. The rates fixed in 1905–6 were revised in 1923–4. How low the rates had become, in spite of the vast changes in the prices of the crops and the value of land, can be seen in the case of wheat. The rate for wheat irrigated by flow was fixed at Re. 1-10-8 in 1862–3. It was raised to Rs. 2-4 in 1867–8 and to Rs. 3 in 1878–9. This rate remained in force till 1905–6 when it was raised to Rs. 4. In 1923 it was raised to Rs. 5.[2]

[1] First assessment was made in 1860.

[2] See the speech of SIR S. P. O'DONNELL, *Proceedings of the United Provinces Legislative Council*, February 2, 1923, p. 250, vol. XII, 1923 (India Office Library).

A periodical revision of rates, whether in the direction of increase or decrease, would bring them into conformity with the prices of the commodities which they help in raising. It may be suggested that the rates should be revised every ten years.

§ 2. *FORESTS*

Area under Forests

With the Reforms the administration of forests was transferred to the Provincial Governments. Forests became a provincial reserved subject.[1]

Although the total area under forests is large in British India—namely 229,896 square miles or 20·8 per cent of the whole—yet it is unevenly distributed. If Burma and Assam are excluded the area under forests in the rest of the Provinces is only 7 to 8 per cent of the whole.[2]

FOREST AREA[3]

PROVINCES	AREA IN SQUARE MILES	TOTAL AREA UNDER FORESTS	PERCENTAGE OF FORESTS TO THE WHOLE AREA OF THE PROVINCE
Bengal ...	76,960	10,802	14·0
United Provinces	106,248	5,251	4·9
Punjab ...	95,315	5,184	5·4
Burma ...	192,275	123,189	64·1
Bihar and Orissa	83,054	2,973	3·6
Assam ...	55,445	21,412	38·6
Central Provinces (including Berar)	98,573	19,398	19·6
North-West Frontier Province	13,099	282	2·2
Madras	142,260	16,474	11·6
Bombay	132,280	14,194	11·5
Total for British India (excluding Delhi Province) ...	1,101,356	266,019	24·2

[1] Except in Bombay, where it was a transferred subject.

[2] The returns of the Agricultural Department do not coincide with those of the Forest Department. The figures used are those of the Forest Department.

[3] *Annual Return of Statistics relating to Forest Administration in British India, 1935–6.*

For an agricultural country with an enormous population this percentage is by all standards inadequate. Before conservancy was adopted (1855), forests were ruthlessly exploited and much permanent damage has been done in certain areas.[1] With the transference of forests to the Provinces (1921) it was expected that the Provinces would practise a more extensive policy of plantation. But the Provinces practised a false policy of economy and it has been customary to treat forest revenue purely from a commercial point of view. It has been repeatedly suggested that forests are a commercial department of the Government and the annual revenue from forests should normally more than balance the annual expenditure.[2]

This, however, is a narrow and a mistaken view of forest finance. It is essential to state here that the revenue from forests should not be judged entirely from a commercial point of view because forests perform a number of collective services which are of benefit to the community as a whole. The correct theory of forest finance should be based upon the *functions* of forests. It is for this very reason that the State preserves forests and controls the policy in order that an individual may not exploit them for his personal gain.

State Control

Before, however, we state the theory of forest finance it may be laid down as a preliminary consideration that forests should be under State control for economic and social reasons. Viewed from a theoretical point of view the State is not a bad forester. There are certain compelling reasons for this view.

Firstly, though the plantation of forests requires a very

[1] e.g. in Malabar by the unrestricted felling of teak and in the United Provinces.

[2] Consider the following sentences of the Taxation Enquiry Committee: 'The case of forests is not dissimilar. These are under the control of the Government, who have something approaching a monopoly in parts of India, but not a complete one. The produce is sold at prices which do not compare unfavourably with those charged by private parties. The purchaser in every case obtains a *quid pro quo*, and is under no direct compulsion to buy. It appears to the Committee that on the whole there is no element of true taxation in the forest revenue and this also does not fall within the scope of their inquiry' (*Report*, par. 14).

large amount of capital, their management, during the period of cultivation, requires the application of scientific principles and agreed rules, rather than the exercise of discretion and enterprise. The scope for an individual entrepreneur's managerial capacity is limited. Management can therefore be performed adequately by salaried experts.

Secondly, forestry to be run on the most economical and successful lines requires vast areas which a State alone is most fitted to own and provide.

Lastly, the gain from forests comes in a very long period, which is always longer than the lifetime of an individual. Most individuals are not prepared to wait for this length of time. The State, however, outlives an individual.[1]

Thus forests should be under State control and management.

Theory of Forest Finance

In India, so far, the theory of forest finance has been entirely based upon the direct utility of forest products. Such utilities may be said to be of a 'private-economic' character. But besides such utilities, it is held by competent authorities that forests exercise an enormous influence on the climate and rainfall of a country. Forests regulate the watercourses of rivers in the valleys through their protection to the headwaters of the streams in mountainous regions. They also check soil erosion and formation of ravine-lands. These utilities may be said to be of a 'collective-economic' character.

An individual entrepreneur is entirely concerned and guided by the private-economic character of the utilities of forests. He may preserve the forests or he may cut them as he finds that one or the other course is more profitable to him. In case he finds it to his interest to follow a policy of ruthless exploitation (for instance, if the price of timber has gone up or for other reasons) there is a clear conflict between the interests of the individual entrepreneur and the interests of the community as a whole. This conflict of interest has been described by Professor de Viti thus:

[1] For these views the writer is indebted to Professor de Viti. See *Principles of Public Finance*, p. 72.

> The cost of maintaining the forest is borne exclusively by the proprietor, who sets against this cost only the private utility to be derived from the timber and the pasturage, and does not take account of the public utility of the forest as such. For this reason the moment that it is to his interest to cut down the forest and it is to the interest of society to preserve the forest, society must assume that part of the cost to which the public utility corresponds.[1]

Forests may be divided into two types (i) 'shelter forests' and (ii) 'commercial forests'. Shelter forests are those whose revenues are not sufficient for their maintenance. In commercial forests revenue pays for expenditure and may result in a surplus.

In the case of shelter forests, as the revenue is not sufficient for their maintenance, the State should assume that part of the expenditure which corresponds to the public utility of the forests. This expenditure, where forests are under State management, should come out of the general revenues of the country. Where forests are under private enterprise suitable restrictions should be placed on uneconomic exploitation.

Commercial forests should yield some surplus after paying for expenditure. While in other commercial enterprises under State control most of the surplus profit is utilized to lighten the burden of taxation, in this case a great part of the surplus should be utilized for the development and cultivation of forests. It is thus that the public utility of forests, which is of vital interest to the country, can be maintained.

Indian Forest Policy

The inhabitants of Northern India are paying the penalty for the ruthless policy of forest exploitation followed before Lord Dalhousie started his scheme of forest conservation (1855). Thousands of acres of land on the banks of the Jumna, the Ganges, the Chambal and the Son have been turned into inhospitable ravine-lands due to rapid deforestation.[2]

[1] De Viti, op. cit., p. 73.

[2] It has been estimated that the total area under ravine-lands in the United Provinces is between half a million and a million acres.

Even more extensive than the ravine-lands on the banks of the Jumna are those in Central India, Gwalior, the Central Provinces and Bombay.[1]

The loss due to the ravine-lands is incalculable. In some areas the soil of whole valleys has been removed by denudation and the rocky subsoil left only maintains with difficulty a thin cover of scrub.[2] No cultivation is possible in such areas. These places were also formerly famous for breeding cattle. But now breeding is an impossibility as the pasture lands have completely disappeared.

But apart from the deforestation which went on for centuries, even in recent times not much has been done to bring forests under scientific management. The result of this narrow policy has been that the average net income from forests in India is only As. 2 per acre whereas the best forests under scientific management earn as much as Rs. 15 per acre.[3]

Forest Revenue and Expenditure

The revenue, expenditure and surplus from forests in British India are shown in the following table:[4]

Year		Revenue	Expenditure	Surplus
		(in thousands of rupees)		
1925-6	...	5,98,70	3,39,63	2,59,67
1926-7	...	6,19,64	3,56,06	2,63,58
1927-8	...	6,13,09	3,56,84	2,56,24
1928-9	...	5,78,09	3,50,61	2,27,47
1929-30	...	6,13,22	3,63,35	2,49,86
1930-1	...	4,72,86	3,52,05	1,20,81
1931-2	...	3,96,07	3,00,74	95,32
1932-3	...	3,74,11	2,87,96	86,14
1933-4	...	3,51,20	2,76,29	74,90
1934-5	...	3,95,07	2,69,98	1,28,32

[1] Howard, A., *Crop-Production in India* (Oxford University Press) 1924, p. 13.

[2] ibid., p. 14. See also Mukerjee, R., *Rural Economy of India* (1926) ch. viii.

[3] *Moral and Material Progress of India, 1924-5*, p. 205.

[4] *Annual Return of Statistics relating to Forest Administration in British India for the Year 1935-36* (issued 1937), Statement XIX (i,ii and iii).

The total provincial revenues and the receipts from forests are shown in the following table:

Provinces	Total provincial revenue, average 1925–35	Income from forests, average 1925–35	Percentage of forests revenue to total provincial revenue	Order in point of percentage
	(in thousands of rupees)			
Madras	16,81,57·8	52,01·5	3·1	6
Bombay	14,77,01·7	64,92·6	4·4	5
Bengal	10,32,74·9	23,45·6	2·3	8
United Provinces ...	12,00,76·8	54,75·0	4·6	4
Burma	9,48,76·0	1,51,58·2	16·0	2
Central Provinces ...	4,89,32·9	85,88·6	17·5	1
Assam	2,50,75·3	24,80·0	9·9	3
Punjab	10,98,85·0	28,31·4	2·6	7
Bihar and Orissa ...	5,49,34·6	8,40 3	1·5	9

Conclusion

The income from forests could have been much increased if productive expenditure had been undertaken by past Governments. During the Reforms period (1921–37) every Provincial Government wanted to increase its immediate revenue from forests without undertaking extensive development. It is to be deplored that past Governments have always looked at this expenditure from the point of view of private finance. The theory of individual finance is that an individual tries to equalize the marginal utilities of his present and future expenditure. Most individuals, however, discount the future to some extent and therefore make less provision for the future. But in public finance since the 'statesman should regard himself as trustee for the future', he should aim at making a more generous provision for the future than would be made by private individuals left to themselves.[1]

The future revenue from forests can be greatly increased if the suggestion thrown out by Dr Anstey—'The whole of the proceeds of the departments might well be spent on more

[1] Dalton, H., *Principles of Public Finance* (Routledge) pp. 20–1.

effective preservation, development and conservative exploitation'[1]—be adopted for some time. No doubt the present Governments would lose for some years but the finances in the future would be greatly increased. Moreover, as forests exercise an enormous influence over the economic life of a nation, such an expenditure would eventually be highly 'reproductive' and would increase the taxable capacity of the future citizen.

§ 3. *EXCISE*

Introductory

Another important source of income is excise. By 'excise'[2] is ordinarily meant a tax or duty on commodities produced within the country, which in India consists of taxes on gasoline, alcoholic beverages, sugar and matches. It also includes the revenue derived from a licence to conduct certain trades, such as those of tobacconists, brewers, distillers, etc.

In India excise duties fall into two classes: (i) those that are levied for the purpose of revenue, and (ii) those that are levied for the purpose of restricting the consumption of commodities such as intoxicants and harmful drugs.

Taxes of the former class are, from the economic and fiscal point of view, the necessary corollary of import duties. 'Restrictive' excises, though primarily meant to check consumption, bring a large amount of revenue as well.

The principal excises falling in the first category are the duties on sugar and matches.[3] The revenues from restrictive excises include the proceeds of duties on the sale and manufacture of 'country spirit' (spirit locally made in imitation of foreign liquor), hemp and drugs and opium.

Under the Reforms the revenue from the sale and manufacture of country spirit, spirits manufactured on European methods, and hemp, and drugs, was credited to provincial accounts. The revenue from opium, imported spirit, matches, and sugar was included in the Central Budget.

[1] ANSTEY, op. cit., p. 176.

[2] 'The word "excise" has no definite meaning in the terminology of taxation.' LUTZ, H. L., *Public Finance* (Appleton) 1936, p. 567.

[3] The cotton excise duty was abolished in the Finance Act of 1926.

Lessons from American Experience

In examining the principles of the liquor excise policy of a government two views are commonly met with: those which advocate total prohibition, and secondly those which support modified prohibition so that the licensed vendor may not be replaced by illicit distillers and smugglers.

The answer to the question, Is prohibition possible? depends upon the question, What would be the cost? The prohibition problem should be studied primarily from the standpoint of administration, because the success or failure of prohibition depends upon the efficiency of administration.

A study of liquor-control administration in the United States during the period when the Eighteenth Amendment was in force has shown that the enforcement of prohibition is an impossibility.[1] Although the Eighteenth Amendment became law it was a dead letter.[2] The action taken by the Congress in controlling liquor consumption was quite inadequate. Vast amounts of illicit liquor were produced as a result of the prohibitive excises, and the consequent high prices gave the bootlegger an excellent opportunity to make exceptionally high profits.[3]

During the pre-prohibition period the illicit manufacture of liquor was secretly carried on. In the prohibition period 'the technique and the financial resources of big business enterprise were applied in the illicit production and sale of liquors'.[4] The evils of incomplete enforcement during the 'dry period' left legacies even after the repeal. 'The bootlegger is still with us,'

[1] The Eighteenth Amendment came into force from January 17, 1920. Under it the manufacture, sale, import, export or transportation of intoxicants was forbidden. 'Intoxicating liquors' were those which contained alcohol in excess of 0·5 per cent. The Repeal Amendment Proclamation was issued by the President on December 5, 1933.

[2] See CATLIN, G. E. G., *Liquor Control* (Home University Library) pp. 135–46.

[3] 'The *per capita* consumption of alcohol has been greater under prohibition than during the war period, with high taxation and restricted production and sale.' WARBURTON, CLARK, *The Economic Results of Prohibition* (Columbia University Press) 1932, p. 260.

[4] LUTZ, op. cit., p. 584.

observed Professor Studenski in *The National Municipal Review*.[1] Bootlegging has become so deep-rooted in American life that thousands of persons find in bootlegging a profitable occupation and are not prepared to leave it. Bootlegging has become a regular business. 'Repeal has materially diminished bootlegging, but it has not eliminated it altogether.'[2]

The one conclusion which the American experience suggests is that 'prohibition is impossible by fiat except in communities where it has overwhelming popular support as a public policy'.[3] Excessive excises do not promote temperance but tempt the bootlegger, and thus the very object of prohibition is defeated.

The moral from the American experience is to discover methods which may be less drastic than prohibition in theory but giving better results in practice. Perhaps the best way to achieve such results is to tax the liquor trade with moderation and to educate public opinion against liquor consumption. Such a policy, it would seem, is a compromise between the protagonists of prohibition and the believers in the doctrine of individual liberty who do not want any law for prohibition.

To achieve the most wholesome results both the methods should work side by side. For the one without the other would not produce the desired results.

To promote temperance, moderation in taxation should be accompanied by: (i) limitation of hours during which intoxicating liquor can be sold; (ii) reduction in the number of shops; (iii) restrictions in quantity for sale both 'on license' and 'off license'; (iv) discriminating taxation of the stronger liquors; (v) curtailment of attractions ordinarily provided in liquor shops; and (vi) educating public opinion against liquor consumption.

The enlightenment of the masses, especially the backward classes (among whom the drink habit is very strong), through propaganda and education, is one of the most essential requisites for the promotion of temperance. Social legislation, however well framed and prohibitive in character, would be impotent

[1] STUDENSKI, P., *Liquor Taxes and the Bootlegger*. Supplement to the *National Municipal Review*, vol. XXIV, January, 1935, p. 63.

[2] STUDENSKI, op. cit., p. 66. [3] LUTZ, op. cit., p. 584.

as breaches of the law easily escape detection.[1] It is upon the bedrock of a sound public opinion that the success of a temperance movement rests. Any attempt to force immediate restrictions would not banish the saloon but would result in disastrous consequences to public morality and the tax policy of the country. The experience of other countries suggests rather strongly that education and propaganda, working by conviction and persuasion, are perhaps no less effective than legislative compulsion in the attainment of prohibition.[2]

Excise Policy of the Provincial Governments

(i) *Taxation of Country Spirit.* The nature and the objects of the liquor excise policy of the Provincial Governments have been matters of bitter attack and it has been commonly held that the Government fosters the liquor traffic for the sake of revenue. This, however, is not correct. A study of the policy followed by the Provincial Governments since the Reforms of 1919 shows that the Government has been on the side of abstinence. It was declared that 'the subordination of considerations of revenue to the promotion of temperance' is the avowed goal of the excise policy of the Government.[3] The United Provinces Government stated that the present policy is 'to promote temperance, and revenue has been sacrificed to achieve this object'.[4]

One of the most important methods to check consumption has been to increase the rate of duty per gallon on 'country spirit'.[5] The fee for vend has also been increased. The follow-

[1] 'The attempt to increase sobriety by means of a law which makes for more objectionable habits of drinking and destroys public morality, is obviously futile. Prohibition is no longer a child of yesterday. Its results can be perceived by all who have eyes to see. These results are such that the only possible conclusion is: the sooner we get rid of prohibition the better.' *Report of the Official Prohibition Enquiry of 1923* (Finland) pp. 149–50. Quoted in *The Prohibition Experiment in Finland* by Joh. H. Wuorinen (Columbia University Press) 1931, p. 94.

[2] WUORINEN, *The Prohibition Experiment in Finland* (Columbia University Press) 1931, p. 237.

[3] See *Administration Report of the United Provinces Government*, 1921–2. p. xiv (India Office Library).

[4] See ibid., 1924–5, p. xxxiii.

[5] All these figures relate to country spirit, unless otherwise stated.

ing statement shows the average total taxation, both from duty and vend fees, on 'country spirit' per proof gallon in distillery areas during 1912–13 and 1934–5.[1]

AVERAGE TAXATION OF COUNTRY SPIRIT[2]

(PER PROOF GALLON)

PROVINCES	1912–13 Rs. A. P.	1934–5 Rs. A. P.
Madras	7 15 7	14 15 6
Bombay (proper)	5 11 10	14 0 4
Sind	6 3 4	13 9 10
Bengal	7 6 10	13 0 7
Bihar and Orissa	3 4 6	5 5 11
United Provinces ...	4 14 2	12 15 6
Punjab	8 9 10	10 10 0
Central Provinces and Berar	6 3 4	8 3 7

The above statement shows that taxation has been increased to an extent almost amounting to prohibition and any further considerable increase in taxation *without proper safeguards* would encourage illicit distillation and smuggling.

(ii) *Number of Country-Spirit Shops.* Table X shows the number of country-spirit shops (in distillery as well as out-still areas) per 100,000 of population and the average area served per shop in square miles in 1912–13 and 1934–5.[3]

It appears from the table that there was a very heavy fall in the percentage of shops in 1934–5 compared with the year 1912–13. The area served per country-shop increased, the 1935 average being 25, 35, 190, 80 and 42 square miles in Madras, Bombay, Sind, Bengal and the United Provinces respectively. Similarly, the number of country-spirit shops per 100,000 persons also decreased. In the Punjab and Bihar and Orissa there were only 2·9 and 4·93 shops per 100,000 persons in 1935.

[1] The figures in these statements are based on the Government of India *Finance Department (Central Revenue) Memorandum on Excise (Intoxicating Liquors) Administration of India for 1934-35*, 20th edition (issued 1937). India Office Library.

[2] See the 'Memorandum' quoted above, statement vi.

[3] ibid., statements iii and iv.

TABLE X

COUNTRY-SPIRIT SHOPS (IN DISTILLERY AS WELL AS OUT-STILL AREAS), 1912–13 AND 1934–5

PROVINCES	TOTAL NUMBER OF COUNTRY-SPIRIT SHOPS DURING		PERCENTAGE OF INCREASE (+) DECREASE (−) OF THE SHOPS OVER THE YEAR	AVERAGE AREA PER COUNTRY-SPIRIT SHOP (IN SQ. MILES) DURING		NUMBER OF COUNTRY-SPIRIT SHOPS PER 100,000 POPULATION DURING	
	1912–13	1934–5	1912–13	1912–13	1934–5	1912–13	1934–5
Madras	8,976	5,603	− 37·58	15·86	25·44	21·68	11·98
Bombay (proper)	2,114	2,135	+ 0·99	35·95	35·68	13·10	11·86
Sind	249	241	− 3·21	188·70	190·58	7·09	6·20
Bengal	1,287	899	− 30·14	61·15	80·66	2·83	1·80
Burma	130	250	+ 92·31	1,775·68	934·82	1·07	1·71
Bihar and Orissa	2,088	1,861	− 10·83	39·84	44·67	6·05	4·93
United Provinces	4,742	2,534	− 45·72	22·62	41·93	10·13	5·24
Punjab	795	690	− 15·20	125·50	129·10	4·06	2·90
Central Provinces and Berar ...	3,759	1,934	− 48·55	26·56	51·83	27·01	12·47
Assam	188	265	+ 40·95	282·00	191·02	2·80	3·06
N.-W. F. Province	37	30	− 23·33	362·65	448·83	1·68	1·26
Delhi	15	10	− 33·3	(1)	57·80	4·00	1·57
Ajmer-Merwara	128	112	− 12·50	12·18	24·20	25·52	19·98
Coorg	33	28	− 15·15	47·94	56·89	18·86	17·14
Baluchistan	62	44	− 29·03	874·65	1,007·27	14·96	10·78
Total ...	24,603	16,636	− 32·38	44·30	65·51	10·09	6·12

[1] Not available.

TABLE XI

CONSUMPTION (ISSUES) OF COUNTRY SPIRIT, 1912–13 AND 1934–5

(IN GALLONS)

PROVINCES	ABSOLUTE CONSUMPTION OF COUNTRY SPIRIT DURING		AVERAGE CONSUMPTION OF COUNTRY SPIRIT PER 100 OF THE POPULATION CALCULATED ON THE CENSUS FIGURES OF 1911 AND 1931		PERCENTAGE OF INCREASE (+) OR DECREASE (−) OF CONSUMPTION DURING 1934–5 OVER THE FIGURES OF 1912–13
	1912–13	1934–5	1912–13	1934–5	1912–13
Madras	1,773,673	8,11,456	4·28	1·73	− 59·58
Bombay (proper)	2,630,869	10,61,545	16·30	5·9	− 63·80
Sind	228,204	1,08,140	6·49	2·78	− 57·16
Bengal	851,534	2,94,665	1·87	0·59	− 68·44
Burma	57,391	67,901	0·47	0·51	+ 8·51
Bihar and Orissa	1,157,636	6,13,342	3·36	2·19	− 47·02
United Provinces	1,689,932	4,77,893	3·61	0·99	− 71·72
Punjab	419,932	3,76,045	2·14	1·51	− 25·40
Central Provinces	1,201,346	3,17,820	8·63	2·07	− 173·50
Assam	247,363	1,34,471	3·68	1·66	− 45·60
N.-W.F. Province	24,296	28,717	1·11	1·17	+ 15·39
Delhi	32,505	28,646	7·82	5·64	− 11·80
Ajmer-Merwara	51,780	65,994	10·33	11·77	+ 13·90
Coorg	26,493	10,107	15·14	6·19	− 51·06
Baluchistan	25,072	32,540	6·05	7·97	+ 24·09
Total ...	10,418,026	4,429,282	4·27	1·63	− 57·5

The extreme reduction in the number of shops, coupled with an increase in the area per shop, shows that a cautious policy of controlling liquor consumption was followed by all the Provincial Governments during the period 1912–35.

(iii) *Average Consumption of Country Spirit.* Table XI points out the heavy fall in both absolute and average consumption of country liquor between the years 1912–13 and 1934–5.

It will be seen from the table that in the Central Provinces and Berar the average consumption of country spirit per 100 of the population in 1934–5 fell by 173·5 per cent compared with 1912–13. The decrease in other Provinces is also quite heavy. This again shows that the temperance movement is firmly, though slowly, gaining ground in the country. In India, as a whole, the average consumption during the period 1912–35 decreased by 57·5 per cent.

Revenue from Excise

The following table shows the revenue from excise in the various provinces:

Provinces	Total provincial revenue, average 1925-35	Income from excise, average 1925-35	Percentage of excise revenue to total provincial revenue	Order in point of percentage
	(in thousands of rupees)			
Madras	16,81,57·8	4,91,92·6	29·3	1
Bombay	14,77,01·7	3,70,80·6	25·1	2
Bengal	10,32,74·9	1,77,85·6	17·2	6
United Provinces ...	12,00,76·8	1,27,33·2	10·6	8
Burma	9,48,76·0	1,07,81·8	11·4	7
Central Provinces ...	4,89,32·9	98,51·8	20·1	5
Assam	2,50,75·3	56,71·0	22·6	3
Punjab	10,98,85·0	1,09,42·7	10·0	9
Bihar and Orissa ...	5,49,34·6	1,16,78·1	21·3	4

Hemp Drugs

The remarks made above apply with equal force to hemp drugs (*ganja*, *charas* and *bhang*), the consumption of which has been greatly restricted. The following figures show the consumption of hemp drugs, each sort separately, total consumption of all sorts taken together and the average consumption (of all sorts taken together) per 1,000 of population during 1912–13 and 1934–5. The figures relate to British India.[1]

TOTAL CONSUMPTION SEPARATELY

(IN SEERS)

	Ganja	*Charas*	*Bhang*
1912–13 ...	415,537	102,731	478,465
1934–5 ...	165,153	61,429	292,166

TOTAL CONSUMPTION AS A WHOLE

(IN SEERS)

1912–13	... 996,796
1934–5	... 515,748

AVERAGE CONSUMPTION

(PER 1,000 OF POPULATION, IN SEERS)

1912–13	... 7·5
1934–5	... 2·12

The average taxation per seer on all descriptions of hemp drugs in some of the major Provinces during 1913–14 and 1934–5 is shown in the following table:[2]

PROVINCES	1913–14 Rs.	1934–5 Rs.
Madras	13·80	45·25
Bombay (proper)	11·6	44·92
Bengal	20·22	65·3
Bihar and Orissa	16·9	56·6
United Provinces	9·0	22·6
Punjab	6·3	46·66

The total receipts from hemp drugs for the year ending March 31, 1935, were Rs. 32·55 lakhs as shown below (24·1 per cent of the total excise revenue).[3]

[1] See *Government of India Memorandum on Excise* (Hemp Drugs) *Administration in India for 1934–35* (issued 1937) statement i.

[2] ibid., statement iv.

[3] ibid., statement i.

	By duty Rs.	By vend fee, etc. Rs.	Total Rs.
Ganja	2,74,053	...	2,74,053
Charas	12,10,577	14,63,959	26,74,536
Bhang	3,06,676	...	3,06,676
Total Rs.	17,91,306	14,63,959	32,55,265

The above figures clearly show that the consumption of hemp drugs has been greatly restricted. The high rates of excise duty have naturally resulted in a fall in revenue.

The Congress Prohibition Programme

With the inauguration of provincial autonomy the Congress Governments in the Provinces followed a policy of prohibition. The prohibition programme created a new range of problems in provincial finance. It is difficult to judge at present the success of the policy, but from the financial point of view the two outstanding issues which need a close examination are: (i) an examination of the proposals for alternative sources of revenue in place of the loss of revenue through excise, and (ii) the problems of overlapping taxation.

Among the important taxes proposed in the provincial budgets for 1939–40, (i) employment tax, (ii) enhanced duty on petrol, (iii) sales tax, (iv) a provincial rate on urban areas, may be mentioned.

The United Provinces Government proposed to levy an employment tax on all salaries of Rs 2,500 and above earned in the Province, whether received or receivable in or outside the Province. Those taxable were persons in service of any kind of the Crown, a local authority, a company or any person, whether whole-time or part-time, and who were drawing a salary therefrom. The schedule of employment tax proposed was as follows:

When the total salary earned in the United Provinces during the year exceeds	But does not exceed	The tax payable for the year shall be
Rs.	Rs.	Rs.
2,500 ...	3,500 ...	90
3,500 ...	4,500 ...	150
4,500 ...	5,500 ...	225
5,500 ...	7,500 ...	325
7,500 ...	10,000 ...	475
10,000 ...	12,500 ...	650
12,500 ...	15,500 ...	850
15,500 ...	17,500 ...	1,100
17,500 ...	20,000 ...	1,400
20,000 ...	25,000 ...	1,725
25,000 ...	30,000 ...	2,500
30,000 ...	35,000 ...	3,000
35,000 ...	40,000 ...	3,600
40,000 ...	45,000 ...	4,300
45,000 ...	50,000 ...	5,100
50,000 ...	60,000 ...	6,000
60,000 ...	70,000 ...	7,000
70,000 ...	85,000 ...	8,200
85,000 ...	1,00,000 ...	9,500
1,00,000 ...	1,25,000 ...	11,000
1,25,000 ...	1,50,000 ...	13,000
1,50,000 ...	1,75,000 ...	16,000
1,75,000 ...	2,00,000 ...	20,000
2,00,000 ...	2,50,000 ...	25,000
2,50,000 ...	3,00,000 ...	30,000
3,00,000 ...	...	32,000

The employment tax is an income-tax in disguise. It would cause undue hardship to persons receiving salaries, while doctors, lawyers and business men who do not receive salaries would escape the burden of taxation. Moreover, the employment tax has raised two issues: (i) concurrent tax jurisdiction and (ii) special responsibilities for the protection of the rights of the Services. The employment tax was passed by the United Provinces Legislative Assembly. The Governor referred the tax

to the Governor-General. The Governor-General while suspending the consideration of the Tax Bill, referred it to the Secretary of State for India for the removal of doubts with regard to the powers of taxation given to Provincial Governments by the terms of item 46 (Provincial Legislative List). A Bill was introduced in the House of Lords and the following changes have been made in the Act and item 46:

> 124A (1) That the total amount payable in respect of any one person to the Province or to any one municipality, district board, local board or other local authorities in the province by way of taxes on professions, trades and callings and employments shall not after 31st day of March, 1939, exceed Rs. 50/- per annum.

For paragraph 46 of the Provincial Legislative List the following paragraph has been substituted:

> Taxes on professions, trades, callings and employments, subject, however, to the provisions of section 124A (1) of the Government of India Act.

It is unfortunate that the Provinces look for supplementary revenues in directions which clash with the interest of the Centre. In the 1939–40 budget the Government of India provided assistance to the Provinces to the extent of Rs. 12 crores under the terms of the Niemeyer Award. The employment tax, besides being inequitable, would cause friction between the Government of India and the Provinces and would result in double taxation.

A petrol tax affects motor transport and diminishes the revenues of the Central Government.

The administrative difficulties in the realization of a sales tax are very great and the burden of the tax would ultimately fall more heavily on the poorer than on the richer classes. Hence the Governor of Bombay on December 4, 1939, decided in consultation with his Advisers not to proceed with the sales tax on manufactured cloth which was authorized by the Bombay Sales Tax Act of 1939. When the Sales Tax Bill was under discussion in the legislature a number of representations were made to the effect that the piece-goods trade in the Province would be seriously affected by the proposed tax. It was urged that wholesale markets in Bombay and Ahmedabad, which are

distributing centres for a large part of India, would be seriously disorganized by the sales tax, particularly as there was no simple method of obtaining refunds on export.

With regard to a tax on retail sales it was urged that it would be necessary for a large number of petty traders—some of whom might be illiterate—to maintain accounts and to submit them for examination to Government inspectors. The tax would thus be both irksome to the taxpayer and expensive to the Government. For these reasons alternative schemes were examined by the Government at the time when the Congress ministries resigned. However, no decision was taken and the difficulties which would have to be incurred in enforcing the sales tax were found considerable. Hence the Governor decided not to proceed with the *ad valorem* sales tax on manufactured cloth.

Provincial rates on urban areas are not in harmony with the principles of local finance. Local taxation is mostly beneficial in character. The revenue from provincial rates would go to the Provincial Government and would affect the already weak finances of municipalities.

Briefly, there is a real danger that the cumulative effect of these taxes on the finances of the Government of India would be ultimately disastrous. The financial solvency and stability of the Centre must be preserved, hence it is of the utmost importance to bring about a harmonious growth of political and fiscal relationship between the Centre and the Provinces. A frank and intimate discussion between the financial authorities at the Centre and the Provinces, through regular conferences of finance ministers, is perhaps the best way of achieving a reasonable interpretation. The futile litigation over the field of concurrent tax jurisdiction so common in some other federations should be avoided in India.

Conclusion

A policy of immediate total prohibition is the cherished ambition of many social reformers and politicians in India. Such a policy, however justifiable it may be from religious, social or other points of view, is not within the scope of practical finance. In the present financial condition of the Provinces, when larger revenues are required to develop the

nation-building departments, it is impracticable to sacrifice this source of revenue. The deficit so caused cannot be easily made up either by the substitution of another tax or group of taxes.

Secondly, prohibition, besides stopping the revenue, would require additional heavy expenditure for its enforcement.[1] Moreover, the cost of prohibition is bound to increase the more vigorous is the policy for its enforcement. Finally, anything like real prohibition in India, where every palm tree, in addition to the *mahua* plant, is a ready source of alcohol, would require a standing army. Hence a policy of prohibition, on the score of expense and difficulty of enforcement, is not possible for India.

[1] The Indian Taxation Enquiry Committee put down 18 per cent of the tax revenues of the country as the probable cost of prohibition.

IX

MISCELLANEOUS TAXES

Scope of the Chapter

'There is no art,' wrote Adam Smith, 'which one Government sooner learns of another than that of draining money from the pockets of people.'[1] One of the most striking features of the post-war fiscal policy of most countries has been the recourse to various miscellaneous taxes on transactions and transfers of property. It will be difficult to enumerate all these taxes; the more important, to which we propose to confine our attention, are: (i) taxes on transfers of property; (ii) death duties: (iii) taxes on entertainments; and (iv) taxation of betting.

In India, taxes on transfers of property are levied under two Acts: (i) The Indian Stamp Act (II of 1899, as modified by the Provincial Acts) and (ii) The Indian Registration Act (XVI of 1908). At present there is no general law levying death duties in India, but there are certain taxes on probates. Each section of the community is governed by its own inheritance law. The exact legal position on the subject is indicated later. Taxes on entertainments and betting are levied by the Provincial Governments as Scheduled Taxes.[2] Finally, fees for litigation are charged under the Court Fees Act.

§1. *STAMPS, REGISTRATION AND COURT FEES*

Theory of Taxes on Transfers of Property

Taxes on transfers of property are collected by means of the Stamp Duty and Registration Fees.[3] The stamp duty is a

[1] ADAM SMITH, *The Wealth of Nations* (Cannan's edition) 1930, vol. II, p. 346.

[2] For the constitutional position on the subject, see ch. iii, pp. 79–80.

[3] Stamp duty is collected in two ways: (i) by fixing stamps on an ordinary paper or purchasing stamped paper for documents relating to transfers of property; and (ii) by a registration fee on documents which according to law must be registered to possess validity.

method of tax collection, not a special type of taxation, e.g. taxes on bills of exchange, sales, cheques,[1] and promissory notes are collected through stamps. The term 'stamp duties' is here used to mean all the duties which are imposed under the Indian Stamp Act II of 1899 (as amended by provincial legislation).[2]

Theoretically, taxes on transfers of property are 'indirect taxes on savings'.[3] In a well-balanced fiscal system direct and indirect taxes are adjusted in such a way that each complements the other. Indirect taxes on consumption fall on income that is produced and consumed. Taxes on transfers of property strike income that is produced and saved. While the one affects acts of consumption, the other strikes acts of production. Taken as a whole they supplement each other and distribute the tax burden more equitably.[4]

The theoretical argument in favour of taxes on transfers of property as an indirect tax on savings may be made clear by means of an example. Suppose A out of an income of Rs. 10,000 has saved Rs. 5,000. On Rs. 5,000 which he has spent, he has already paid consumption taxes, say, 10 per cent. Let us suppose he invests Rs. 5,000 in house property; on this saving he has to pay the stamp duty and registration fee when he purchases the house and death duty when the property passes on to his heirs.

Meanwhile, if the house is sold the new buyer will have to pay the tax and the 'old buyer' when he reinvests the amount will again have to pay the tax. Of course, there will be double taxation, if the same amount is invested several times. To eliminate double taxation in the daily transfers of property is difficult. The best way to minimize the hardship is to keep the

[1] By the Indian Finance Act 1927 the stamp duty on bills of exchange and cheques was abolished.

[2] The Indian Stamp Act II of 1899 has been amended several times. In 1910 the Government imposed additional duties on the issue of debentures, share warrants to bearer, transfers of shares, etc. For an excellent account see *The Indian Stamp Act (II of 1899)* by Sir James Westland. It contains the report of the Select Committee which sat on the Act (India Office Library).

[3] De Viti, op. cit., p. 357.

[4] See de Viti, op. cit., pp. 354–6.

tax rates low. Death duty rates, as they are paid only once, are always kept at a high figure.

Taxes on transfers of property (collected through stamp duties and registration fees) are explained by two theories: (i) the theory of the fee and (ii) the theory of the tax. In Appendix I it has been pointed out that stamp duties and registration fees partake of the characteristics of both the fee and the tax. As stamp duties and registration fees perform special public service on property transfers, they come under the category of the fee. But, as explained above, this is not the sole basis and reason for their levy. They are indirect taxes on savings, and the transfer of property is merely the occasion for collecting them. The theory, briefly, may be stated in the words of Professor de Viti: 'Hence the charge that is levied at the time of registering a deed of sale would consist, first, of a part that is the fee for the special service of registration; second, of a part that is the fee corresponding to the special service which consists of the pledge assumed by the State to insure the execution of the contract; third, of a part—the largest—that is an indirect tax on savings.'[1]

A conspicuous example of this is found in stamp duties and registration fees. Stamp duties and registration fees, though they perform special public service on property transfers or on other transactions, are more akin to taxes than fees. There are two reasons for this. Firstly, whereas a fee gravitates towards the cost of production, the charges under stamp duties and registration fees have no relation to the cost incurred by the State in performing these services.[2] Secondly, the payment of stamp duties and registration fees is compulsory, non-compliance with which renders the act or the transaction void in the eye of the law.

Objections to Stamp Duties

Stamp duties on the transfers of property were not favoured by Adam Smith. 'Such taxes, even when they are proportional

[1] De Viti, op. cit., p. 36.

[2] Stamp duties are either *ad valorem* or are fixed, registration fees are regressive, as the charges for registering a document decrease as the value of the document increases. See Appendix I.

to the value of property transferred, are still unequal; the frequency of transference not being always equal in property of equal value. When they are not proportional to the value, which is the case with the greater part of the stamp duties, and duties of registration, they are still more so.'[1]

John Stuart Mill opposed a tax on the purchase and sale of land because 'it almost always fell on a necessitous person, and in the crisis of his circumstances'. His further objection was that the tax was an obstacle to 'the sale of land or other instruments of production '.[2]

Hobson condemns the raising of revenue through stamp duties as 'they not infrequently constitute an enormous burden upon the payee, and a real interference with freedom of purchase or other business arrangement.[3]

Adam Smith's objection, that as the stamp duties do not take into consideration the frequency of transference their burden is unequal, contains an element of truth. This objection applies equally to death duties and to all the duties on the daily transfers of stocks and shares and other mobile property. The best way to overcome this objection is to keep the stamp rates low.

Mill's objection that stamp duties fall on a necessitous person in the crisis of his necessities is not always correct because quite a large number of transfers of property are due to the extravagance of the owner or to other reasons. In the United Provinces the majority of the talukdars are indebted, and the stamp duty on the sale or mortgage deeds, surely, did not fall in the crisis of the necessity of the talukdar.

Moreover, as the rates of the duty are not high they are not an obstacle to the transfer of property.

Hobson's objection is also hardly correct because the rate-schedule of the tax is always kept at a level which does not tempt people to avoid the tax by legal or illegal means, e.g. a high

[1] ADAM SMITH, op. cit., p. 347. Stamp duties on transfers of property are different from stamp duties upon law proceedings (i.e. court fees). Adam Smith was opposed to the former but favoured the latter. See *The Wealth of Nations*, p. 212.

[2] MILL, J. S., *Principles of Political Economy* (Ashley's edition) p. 858.

[3] HOBSON, J. A., *Taxation in the New State* (Methuen) 1919, p. 216.

stamp duty on immoveable property may lead to evasion by mutual understanding between the buyer and the seller, the latter declaring the value of the property below that at which it is actually sold.

Another point to which none of the views quoted above has given attention is that a large number of transfers of property do not involve a consideration, e.g. a gift of property given for religious, educational or other charitable purposes. How can such transfers fall on a 'necessitous person'?

Income from Stamps and Registration

The income from stamps and registration is given in Table XII.

Principal Guides to Stamp Rates and Registration Fees

The Indian Taxation Committee devote considerable attention to the question of stamp duties. As the subject requires legal knowledge to analyse the working of the Acts, it is not possible for me to offer concrete suggestions to amend the law. On the whole, however, the committee were of the opinion that the Indian Stamp Act fulfils its purpose satisfactorily. Therefore they did not suggest any drastic changes but merely recommended some alterations in the details of the Act. It is important, however, to state that the productiveness of the stamp duties begins to diminish after a certain stage.

Excessive rates either retard business or result in evasion. It is generally agreed that in fixing stamp rates the following three general considerations should be kept in mind:

(i) The point at which the value of the convenience or utility attaching to the use of a particular kind of document or resort to a particular kind of transaction approaches the amount of the stamp duty involved;

(ii) The point of diminishing returns, or in other words, what the traffic will bear; and

(iii) The point at which hardship on any class of the community is involved.

Theoretically, the scales adopted for the fees levied on documents for registration should depend upon two factors:

TABLE XII

INCOME FROM STAMPS AND REGISTRATION

(IN THOUSANDS OF RUPEES)

PROVINCES	TOTAL PROVINCIAL REVENUE, AVERAGE 1925–35	INCOME FROM STAMPS, AVERAGE 1925–35	PERCENTAGE OF STAMPS RECEIPTS TO TOTAL PROVINCIAL REVENUE	INCOME FROM REGISTRATION, AVERAGE 1925–35	PERCENTAGE OF REGISTRATION RECEIPTS TO TOTAL PROVINCIAL REVENUE
Madras	16,81,57·8	2,30,60·2	13·7	34,65 0	2·1
Bombay	14,77,01·7	1,62,80·4	11·0	12,63·1	0·9
Bengal	10,32,74·9	3,19,14·3	30·9	27,75·9	2·7
United Provinces ...	12,00,76·8	1,72,69·8	14·4	12,68·1	1·1
Burma	9,48,76 0	60,27·2	6 4	5,84·3	0·6
Central Provinces ...	4,89,32·9	61,82·2	12 6	5,92 0	1·2
Assam	2,50,75·3	20,23 6	8·1	2,07·7	0·8
Punjab	10,98,85·0	1,12,77·7	10·3	9,02·8	0·8
Bihar and Orissa... ...	5,49,34·6	1,08,59·1	19·8	4,86·5	0·9

Note the high receipts from stamps in Bengal. This fact led Sir John Simon, Chairman of the Indian Statutory Commission, to remark that Bengal lived on the proceeds of litigation.

(i) the cost of performing the service, which depends on the length and intricacy of the document; and (ii) the value of the security which registration gives in the buying and selling of property. The payment for the first consists of the fee; in the second there is the element of taxation.

Court Fees[1]

Another tax which has been a subject of controversy is that of court fees. While Adam Smith and Sir Henry Maine favoured the taxing of litigation, Bentham and Mill condemned the taxation of justice.

Adam Smith remarked that 'justice never was in reality administered gratis in any country'.[2] He was of the opinion that the whole of the expenses on the administration of justice could be recovered by court fees.

Sir Henry Maine during the discussion on the Indian Court-fees Bill in the Imperial Legislative Council in 1869 made it clear that 'a vast amount of litigation in this country arises from complications of fact produced by the neglect of the litigants themselves or their predecessors in title, by unbusiness-like habits, by heedlessness or by sheer folly'. Moveover, in a large number of cases, e.g. in the winding-up of a company or the interpretation of a will, the general taxpayer should not pay for the particular benefit received by the litigant. Sir Henry rightly observed that 'the extreme theory that the litigant should contribute nothing towards the expenses of litigation' is not sound in theory.[3]

'In the enumeration of bad taxes,' remarked Mill, 'a conspicuous place must be assigned to law taxes . . . like all needless expenses attached to law proceedings, they are a tax on redress, and therefore a premium on injury.' Mill thought that 'those who are under the necessity of going to law are those who benefit least, not most, by the law and its

[1] Court fees are realized through stamp duty. The revenue from them is shown in Table XII.

[2] ADAM SMITH, op. cit., p. 210.

[3] *Proceedings of the Imperial Legislative Council*, September 10, 1869 (India Office Library).

administration. To them the protection which the law affords has not been complete'.[1]

Bentham in his *Protest against Law Taxes* powerfully puts the case against the taxation of litigation in the following words:

> A law tax is the worst of all taxes, actual or possible; that for the most part it is a denial of justice; that at the best, it is a tax upon distress; that it lays the burthen, not where there is most but where there is least, benefit; that it co-operates with every injury, and with every crime; that the persons on whom it bears hardest, are those on whom a burthen of any kind lies heaviest; and that they compose the great majority of the people; that so far from being a check, it is an encouragement to litigation.[2]

Bentham's and Mill's theory that litigation should not be charged is particularly inapplicable to India, where a large amount of litigation is frivolous. Litigation is an important cause of the indebtedness of the peasantry. If court fees are removed in India a flood of litigation will ensue which will be ruinous to the interests of the country.

In fixing the court fees it has always been the aim of the Government that justice should not be denied to those who need it. Criminal justice is practically free in a country. For civil justice the scale of fees has been pitched at a point to cover the cost of the administration.

To further facilitate the dispensation of justice, it may be suggested that the courts in India should follow the practice of the English County Courts where the court fees are recovered in two instalments—one at the institution of the suit and the other at the trial or hearing. Such a change in practice would lighten the burden of the court fees and make justice more easily accessible.

[1] MILL, op. cit., pp. 881–2.

[2] JEREMY BENTHAM, *County Courts. A Protest against Law Taxes* (James Ridgway) 1853, p. 43.

§2. *DEATH DUTIES*

The Equity of Death Duties

A tax on the transfer of property from the dead to the living is a permanent feature in the revenue system of almost every democratic State. The tax as a fiscal instrument has been justified from a social as well as from a theoretical point of view. 'Property rights', observes Professor Pigou, 'are the child of law.'[1] It is universally recognized that as the State protects the property of the individual after his death, it is justified in taking a share of the property before it passes on to the beneficiaries. Gladstone in his speech on succession duties remarked: 'The carrying of property in perfect security over the great barrier which death places between man and man is perhaps the very highest achievement, the most signal proof of the power of the civilized institutions . . . and an instance so capital of the great benefit conferred by law and civil institutions upon mankind, and of the immense enlargement that comes to natural liberty through the medium of the law, that I conceive nothing more rational than that, if taxes are to be raised at all, the State shall be at liberty to step in and take from him who is thenceforward to enjoy the whole in security that portion which may be *bona fide* necessary for the public purpose.'[2] Hence a statute passed by the State for the curtailment of the right of bequests in respect of the property hitherto enjoyed by the deceased is just.

Apart altogether from the social point of view death duties are theoretically justified on the principles of ability, certainty and convenience. It is now commonly recognized that any single test of ability for purposes of taxation, whether it be amount of income, or capital, of savings or of expenditure, is bound to have many defects.[3] Hence we have a manifold tax system. Although income is the best single measure of ability, it is not comprehensive. Therefore a different test of ability to pay is needed. Death duties, charged on capital, fill the gap.

[1] PIGOU, A. C., *A Study in Public Finance* (Macmillan) p. 7.
[2] *Hansard*, Vol. CXXXII, p. 267 (1853).
[3] See Appendix I.

They provide for an 'important element of ability which an income-tax cannot recognize, except in the most inadequate way'.[1]

This may be made clear by an example. Suppose A, B and C each have an income of Rs. 10,000, from earnings, speculative holding of shares, and gilt-edged securities, respectively. Both B and C are enormously better off than A, and C is also better off than B. But all of them pay the same amount of income-tax in India.[2] This obviously is unjust. A has nothing but a power of earning; B's income will fluctuate with the money market; C need have no worry with financial uncertainties at all. Income-tax alone, however nicely differentiated, is entirely inadequate to meet the equities of the case. This kind of maladjustment can be substantially removed by death duties. The death duty rates in most countries are progressive, the rates being heavy in the higher ranges of capital.

Moreover, death duties are also a useful supplement to income-tax in another way. The death duties extend (e.g. the English estate duty) to assets such as jewels, pictures, furniture and other goods not producing income; they also tax wealth due to unearned increment in land and other capital transactions.

Thus death duties on the score of ability are justified. Equality in taxation is secured to a greater extent than is possible under income-tax alone.

Death duties are in conformity with Adam Smith's canons of certainty and convenience. The amount which each individual is bound to pay is certain, and not arbitrary. The time of payment, the manner of payment, the quantity to be paid are clear and plain to the contributor, the deceased, and to every other person.[3]

Finally, death duties are most convenient to pay, whether regarded from the point of view of the owner of the property or

[1] *Report of the Committee on National Debt and Taxation.* Cmd. 2810 (1927) p. 178. (H.M.S.O.)

[2] In Indian income-tax there is no differentiation between earned and unearned incomes. In Great Britain an earned income relief of £250 is given by the income-tax. In the above example it would go to A.

[3] ADAM SMITH, op. cit., pp. 310–11.

the beneficiaries. Death duties are regarded as deferred income-tax, the payment of which has been postponed to the time when the property passes from the deceased to those who inherit it. The guiding principle of every tax system must be to reduce the sacrifice of the taxpayers to a minimum. Assuming a given revenue is to be raised by the Government, the resentment of the taxpayers will be reduced to a minimum if, instead of an additional income-tax exacted during the lifetime of the deceased, the amount is collected through death duties. The time for their collection is most opportune; for the heir who inherits the estate feels no great sacrifice, while the deceased beyond the grave is incapable of feeling the loss.

Objections to Death Duties

Theoretically, death duties are open to two objections. Firstly, their yield is uncertain. Secondly, they cause inequality between one estate and another because they cannot take into consideration the varying frequency of transfer of property. As Dr Benham puts it: 'A Chancellor of the Exchequer cannot estimate their yield at all accurately for he does not know which rich men will die during the coming year. Over, say, fifty years, one estate may not change hands at all and so may yield nothing in death duties, while another may change hands several times.'[1] Death duties are thus arbitrary in character.

In spite of these objections death duties are found in the tax system of most countries. The reason for their existence (apart from theoretical considerations) 'is mainly the practical one of plucking the goose with the least squealing'.[2] The most favourable time for their collection reduces the sacrifice of the taxpayers to a minimum and hence causes least resentment among them.

Types of Death Duties

Death duties are usually classified under two broad categories: (i) an estate duty (e.g. the English estate duty) levied on the estate as a whole; and (ii) a succession duty (e.g. the English legacy and succession duty) levied on the separate

[1] BENHAM, *Economics*, p. 306. [2] ibid., p. 306.

portions going to each beneficiary. The estate duty is usually graduated by reference to the aggregate value of the property passing, without reference to the interests of the different beneficiaries. In the case of the succession duty the rates are determined solely by the relationship of the beneficiary to the deceased. The succession duty is charged not upon the whole corpus of an estate but upon the interest which a person derives from property left to or devolving on him upon death.[1] The rates are always lower where the beneficiary is the wife, husband or children; they become higher as the relationship of the beneficiaries to the deceased becomes more distant.

Both these types of duties possess some advantages. Simplicity of administration and productivity are the strong features of the estate duty. The succession duty, on the other hand, may be said to be more equitable. Evasion is also less easy under an estate duty than under a succession duty. As the succession duty is based on relationship, the amount of legacy and the wealth of the inheritor, there may be a greater degree of abstract justice in its case. It is, however, advantageous to have both the duties in the tax system. Each will complement the other.

Death duties may be graduated in three ways: (i) the tax may vary with the size of the estate transferred: e.g. the rates are progressive in the case of the English estate duty; (ii) the rates may vary with the relationship of the beneficiaries to the deceased: the English legacy and succession duties are graduated on this principle; (iii) the rates may vary with the amount

[1] In England the Legacy Duty applies to all moveable property of an individual dying domiciled in Great Britain. The Succession Duty applies to all moveable property not liable to Legacy Duty, under a British Settlement, and to all immoveable property in Great Britain. The rates are:

One per cent where the beneficiary is the husband, wife, or lineal issue or ancestor of the author of the benefit, subject to exemption where the total value of the property passing does not exceed £15,000, or where the total individual benefit does not exceed £1,000, or in some instances £2,000.

Five per cent where the beneficiary is a brother or sister, or a descendant of a brother or sister.

Ten per cent in all other cases.

See Cmd. 2810, pp. 194–5.

inherited by each beneficiary and his wealth: death duties in some of the Continental countries are based on the third form.

Probate Duties in India

In India there are no death duties (i.e. estate duty or succession duty). There are, however, certain small duties levied under the Court-fees Act (1870) on probates, letters of administration and succession certificates, which partake to some extent of the nature of the death duties levied in other countries. But the scope of these duties is extremely limited. As the Hindus, Mohammedans, Indian Christians, Europeans, Anglo-Indians, Jews and Parsis are each governed by different laws of inheritance, the application of the duty is different in each case. The duty differs with race, religion and locality.

For the sake of convenience the question may be considered under three headings:

(i) The existing rate and yield from the duties (hereafter to be referred to as 'probate duties').

(ii) The law on the subject.

(iii) The best method of making all succession liable to taxation in India.

The Rates of Probate Duties and their Yield

Prior to 1910 probate duties were levied at the flat rate of 2 per cent on the value of property exceeding Rs. 1,000 in value, when probates, letters of administration, succession certificates, etc., were granted to an executor or administrator. By the Act of 1910 (Act VII) the principle of graduation was introduced and the rates stood as follows:

	per cent
Where the amount or value of the property exceeded Rs. 1,000, but did not exceed Rs. 10,000	2
Where the amount or value of the property exceeded Rs. 10,000, but did not exceed Rs. 50,000	2½
Where the amount or value of the property exceeded Rs. 50,000	3

Since then the rates have been raised in Bengal, Bihar and Orissa, and Assam to 5 per cent and in Bombay to 7 per cent.

The receipts on account of the probate duties in the five major Provinces is given in the following table:[1]

Year	Madras	Bombay	Bengal	Punjab	United Provinces
1932–3 ...	1,77,876	11,07,629	33,75,830	60,434	1,90,895
1933–4 ...	1,73,360	10,12,966	15,33,354	58,647	1,76,612
1934–5 ...	1,48,042	9,52,943	13,02,052	70,634	1,81,552
1935–6 ...	1,03,675	7,50,207[2]	11,76,660	61,087	1,22,401
1936–7 ...	...	15,86,817[2]	...	73,960	2,00,883

The Law on Probate Duties

The law on the subject is complicated and may briefly be put as follows:

Under section 9 of the Administrator-General's Act (1913), the Administrator-General is required to obtain letters of administration in respect of the property of every person (except those exempted) exceeding the value of Rs. 1,000, if no person entitled to the grant of probate or letters of administration has applied for them.[3] The effect of this provision is that the beneficiaries to the estates of all Europeans, Anglo-Indians, Armenians, Jews, or persons of foreign domicile (dying testate or intestate) are compelled to obtain letters of administration and pay probate duties. Sections 187 and 190 of the Indian Succession Act (1865) necessitate probate or letters of administration only in cases where a right is sought to be established in a court of law. Under section 187, where a will exists no right can be established in a court of law unless probate or letters of administration are obtained. Section 190 demands letters of administration, in the case of intestate succession, prior to the establishment of any claim in a court of law. These sections

[1] Source: *Annual Reports on the Working of the Stamps Department* of the Provincial Governments.

[2] Excludes the yield from Sind. For the other years the income from Sind is included.

[3] Exempted persons under the Act are Indian Christians, Hindus, Mohammedans, Parsis, Buddhists or persons exempted by the Governor-General under section 332 of the Indian Succession Act (1865).

are not applicable to Mohammedans, Hindus, Buddhists or persons exempted under section 332 of the Indian Succession Act. The Native Christian Administration of Estates Act (VII of 1901) has exempted Indian Christians from section 190. The result of these provisions is that Parsis have to pay probate duties both in the case of testate and intestate succession, while Indian Christians have to obtain letters of administration only in the case of testate succession. Under the Hindu Wills Act of 1870 (as amended by section 154 of the Probate and Administration Act of 1870) Hindus, Sikhs, Buddhists, and Jains who, residing in Bengal and in the towns of Bombay and Madras, desire to establish a claim in a court of law, have to obtain probate and letters of administration in respect of wills and codicils made within these places. If wills and codicils are made outside these areas but relate to immoveable property situated within those areas, probate or letters of administration are necessary. Except in the above cases, unless claims are to be established in a court of law, the taking of probates or letters of administration, in the case of Hindus and Mohammedans, is optional.

The Indian Taxation Enquiry Committee sum up the legal position relating to the applicability of the duty in the following paragraph:

> The assets in India of Europeans, Anglo-Indians, Armenians, Jews, and persons of foreign domicile must pay duty whether there is a will or not, or whether any right is sought to be established in court or not. The estates of Parsis, whether there is a will or not, and the estates of Indian Christians, where there is a will, must pay duty wherever the estate be situated in India, though only when a right is sought to be established in the courts. The estates of Hindus, where there is a will made in, or relating to, immoveable property situated in the Lower Provinces of Bengal or the cities of Bombay or Madras, must also pay duty, but only again when a right is sought to be established in the courts. The estates of all Mohammedans who die testate or intestate, the estates of all Hindus and Indian Christians who die intestate, and the

> estates of all Hindus who die leaving wills not falling within the scope of the Hindu Wills Act need pay no duty, unless the parties themselves apply for and obtain probate or letters of administration.[1]

The effect of all the legislation is that as probate, letters of administration, and succession certificates are taken only by a small section of the population of India, the burden of the tax is not fairly distributed among the various communities. Hindus and Mohammedans, who generally do not make wills, are obviously escaping the burden of taxation. The burden of taxation is heaviest on Europeans and persons of foreign domicile. The yield from probate duties is necessarily low.

Mitakshara and Dayabhaga Law

Another difficulty in the imposition of death duties in India is the Hindu law of inheritance. The two schools of Hindu law—the Mitakshara and Dayabhaga—differ in regard to the laws of inheritance. According to the Mitakshara law (which is in force outside Bengal) each son upon his birth takes an interest equal to that of his father in ancestral property, whether it is moveable or immoveable. 'On the death of the father the son takes the property, not as his *heir*, but by *survivorship*.'[2] The coparceners in a Hindu joint family do not own property as individuals. Hence a Hindu joint family is a corporate body 'having a continuous existence notwithstanding the death of individual members'.[3]

Under Dayabhaga law, the sons do not take any interest in ancestral property in the lifetime of their father. Their rights rise for the first time on the father's death. In short, under Mitakshara law the sons acquire an interest by birth; in Dayabhaga law they acquire an interest with the father's death. The result of the above distinction is that the interest of the coparceners under Mitakshara law fluctuates with the birth or

[1] *Report of the Taxation Committee, 1924–25*, p. 268

[2] MULLA, D. F., *Principles of Hindu Law* (Eastern Law House, Calcutta) 1936, p. 323.

[3] TREVELYAN, SIR E. J., *Hindu Law as administered in British India* (Thacker Spink) 1929, p. 213.

death of other coparceners. Hence the imposition of death duties is a matter of difficulty in the case of Hindu joint families governed by the Mitakshara school of law.

Results of the Differences in Laws

From the above legal summary three important consequences follow. First, the choice of the methods of taxation is limited. Any inheritance tax in India (on account of the Mitakshara school of law) which is based on the separate inherited share of each recipient rather than on the whole estate is not possible for India. Hence the application of the principle of progression, based on the windfall element arising out of the degrees of relationship of the heir to the deceased, cannot be applied in taxing the estate. The English legacy and succession duties are therefore ruled out.

Secondly, the discrimination in taxation of an estate according to the age of the estate is also not possible. It has often been suggested that in taxing estates graduation according to the time element should be introduced. Thus the older the estate the higher should be the rate of the tax on that portion; i.e. taxation should be according to the number of times the estate has already changed hands. Since inheritance under Mitakshara law is by *survivorship* discrimination in taxation according to the age of the estate is also ruled out.

Thirdly, the English estate duty, which taxes the whole estate (rather than the shares which pass to each beneficiary), appears to be most suitable to Indian conditions.

The Best Method to make All Succession liable to Taxation

The first necessity for the imposition of a death duty in India is a law passed by the Central Legislature which shall bring all classes (i.e. races or religions) under its administration. The existing duties levied under the Court-fees Act are highly inequitable, as they differentiate between race, religion and locality. The new law should abolish the existing rates and introduce uniform rate-schedules applicable to all classes throughout India.

In order to avoid legal difficulties and to distribute fairly the tax burden among the various communities, a death duty on

the lines of the English estate duty should be introduced. The duty should be progressive, increasing with the value of the property. Property below a certain limit should be exempt from the payment of the duty.

Thirdly, in order to ensure effective administrative control and to avoid the risks of double taxation, centralized administration is necessary. Therefore, the administration of the duty should be entrusted to the Board of Central Revenue, Delhi. The proceeds of the duty should be distributed to the units of the Federation (i.e. the Provinces and States.)

Fourthly, in the case of a Hindu joint family the duty should be levied only when one of the coparceners of the oldest generation dies. Thus in a joint family of three brothers and four sons the duty should only be payable when one of the brothers dies. The duty on each occasion should be levied on one-third of the total value of the estate. The duty would not be payable when one of the sons dies during the lifetime of one of the brothers. When all the three brothers die, and the four sons remain, the duty payable on the occasion of the death of one of the sons would be levied on one-fourth of the value of the estate. This will go on for each generation. For purposes of taxation 'self-acquired property' and 'ancestral-property' should be taxed together. This scheme possesses simplicity and would lead to equality in taxation among the various communities.

Fifthly, to ensure efficient administration, the law in India should include some of the provisions of the Commonwealth of Australia's Estate Duty Assessment Act (1914–28). The law should provide that:

(i) The person succeeding to an estate should be compelled to report his liability to the Collector or a revenue authority within a specified time.

(ii) Any person who obstructs or hinders any officer acting in the discharge of his duty under the law should be liable to a fine.[1]

(iii) Any person who fails or neglects to furnish any return or information or makes or delivers a return which is false in any particular should be liable to a fine.[2]

[1] *The Commonwealth of Australia: The Estate Duty. Assessment Act* (1914–28) section 46. The fine in Australia is £50.

[2] ibid., section 47. Under this section the fine is £100.

(iv) Any person who with interest to defraud, in any return understates the value of any estate; or evades the duty, should be liable to a fine.[1]

(v) Transfers of property (i.e. gifts *inter vivos*), real or personal, made within three years before the death of the transferor (as is the rule in England) should be liable to duty.

(vi) The duty should be paid by means of a stamp duty.

Finally, the following rates of duty, suggested by the Taxation Committee, may be adopted in the beginning:

	Rs.		PER CENT
	5,000	...	Nil
NET	5,000	...	½
,,	10,000	...	1
,,	30,000	...	1½
,,	50,000	...	2
,,	1,00,000	...	2½
,,	3,00,000	...	3
,,	5,00,000	...	4
,,	10,00,000	...	5
Amount in excess of	20,00,000	...	6

§ 3. *SCHEDULED TAXES*

Taxation of Entertainments

Taxation of entertainments is popular in many countries. It is, among many other countries, levied in Australia, Canada, Italy, Germany and England. In England the entertainments duty was first imposed by the Finance (New Duties) Act, 1916. In India taxes on entertainments were levied under the scheduled taxes in Bengal and Bombay in 1922 and 1923.[2]

The tax consists of a simple levy on payment for admission to entertainments, approximately at the rate of 25 per cent. The rates of the tax are fixed by reference to price. The following table will illustrate the graduation under the Bengal Amusement Tax:

[1] ibid., section 48. The fine in the Act for this offence is £500. (Information obtained from Australia House, London.)

[2] See *The Bengal Amusement Tax Act* (V of 1922); *The Bombay Entertainments Duty Act* (I of 1923). See ch. iii for a list of scheduled taxes.

Where the payment, excluding the amount of the tax:	Tax
(i) is more than eight annas but less than twelve annas	One anna
(ii) is twelve annas or more but is less than one rupee eight annas	Two annas
(iii) is one rupee eight annas or more but is less than two rupees eight annas	Four annas
(iv) is two rupees eight annas or more but is less than three rupees eight annas	Eight annas
(v) is three rupees eight annas or more but is less than four rupees eight annas	Twelve annas
(vi) is four rupees eight annas or more but is less than six rupees eight annas	One rupee
(vii) is six rupees eight annas or more but is less than nine rupees eight annas	One rupee eight annas
(viii) is nine rupees eight annas or more but is not more than ten rupees	Two rupees
(ix) is more than ten rupees, for the first ten rupees and for every ten rupees or part of ten rupees over ten rupees	Two rupees[1]

The revenue derived from the entertainments tax in Bombay and Bengal during the period 1932–7 has been as follows:[2]

	Bombay	Bengal
1932–3	Rs. 7,65,898	Rs. 3,95,070
1933–4	8,60,068	4,11,356
1934–5	7,73,990	4,04,141
1935–6	7,85,000	6,00,000
1936–7	19,72,322[3]	6,50,000

General Considerations

The taxation of entertainments, being in the category of a luxury tax, is extremely desirable. It taxes that type of expenditure which is peculiarly suitable for taxation. The tax under the existing scale appears to be quite a light burden for all classes.

The tax is eminently suitable for extension to other Provinces. Owing to the cinema craze the total tax revenue is

[1] See section 4 (3) of the Bengal Amusement Tax Act.

[2] *Annual Budget Reports.*

[3] For 1936–7 the Budget Report does not give the yield from the Entertainment Tax separately. It is combined with the Betting Tax.

bound to increase in the future. It may be noted, however, that entertainments of a wholly educational character or only for the amusement of children or for educational and scientific purposes (and not conducted for profits) should be exempted from taxation.

Lastly, in view of the local character of the tax, it seems desirable that a share of the proceeds of the tax should be given to the local authority. The power to levy the tax, the rates of the tax and its administration should, however, be in the hands of the Provincial Governments.[1]

Taxation of Betting

An important, but questionable, source of income of many States is the revenue derived from lotteries and taxation of betting. In the past many States conducted periodical lotteries; in many States, lotteries became a State monopoly. Out of the proceeds of the taxation of lotteries the State even built churches. St John's Cathedral in Calcutta was the result of this, and not a few town halls owe their origin to this form of taxation.[2] Today the more important question, with which we are concerned here, is the taxation of lotteries and private betting.

On the question whether lotteries and betting are fit subjects of taxation, widely divergent opinions are held. Broadly viewed the taxation of betting is in the nature of luxury taxation. The taxation of race-course betting is a case in point. No doubt betting is a fool's game where men often make the 'absurd presumption in their own good fortune', still taxation is both justifiable and desirable. A theoretical basis for lotteries taxation may perhaps be found in the 'special ability' or 'windfall' taxation principle developed by Lord Stamp. '*Irregular or spasmodic receipts*,' he observes, '*which were not required or essential in order to provoke or sustain any economic effort or sacrifice, possess in the abstract a higher degree of "ability to pay" than corresponding amounts of regular income or capital.*'[3] The income from lotteries is essentially in the nature of a windfall and theoretically

[1] See ch. xii.

[2] SHIRRAS, G. F., *The Science of Public Finance* (Macmillan) Vol. II, 1936, p. 681.

[3] STAMP, op. cit., p. 62. The italics are his.

is justified for a special charge. The State has a right to levy a charge on lotteries, like the well-known Calcutta sweepstake, which frequently awards prizes of over Rs. 7,00,000.

The taxation of betting and lotteries is also desirable. It is often alleged that by legalizing them the State 'promotes and encourages the spread of this pathological condition among its people as a means of obtaining public revenue'.[1] The above remarks of Professor Lutz have not taken into consideration that taxed and legalized betting would regulate it and diminish the malpractices associated with it. A wrong thing is not encouraged by diminishing the money profits from its practice.[2] Thus taxation of betting and lotteries, on theoretical as well as on social grounds, is justifiable and desirable. The objections, as Professor Bastable pointed out, are rather moral than economic.[3]

Betting Tax in India

A betting tax is common in many countries. It has been carefully worked out in Australia. A betting tax is levied in India in several Provinces, for example, Bengal, Bombay and the United Provinces. The Bengal Amusements Tax Act taxes certain forms of betting.[4] The tax is levied at the rate of 4 per cent on all money paid into the totalisator. A similar tax (of 4 per cent) is also paid by licensed bookmakers to winning backers. In Bombay, where bookmakers are not allowed, a totalisator tax of 4 per cent is levied.[5] Burma has also adopted the tax. The yield from the tax in Bengal and Bombay in the period 1932–7 is shown below:[6]

	Bombay	Bengal
1932–3	Rs. 11,17,647	Rs. 11,30,581
1933–4	10,52,363	7,10,955
1934–5	10,59,534	9,72,516
1935–6	9,30,000	9,40,000
1936–7	19,72,322[7]	9,40,000

[1] Lutz, op. cit., p. 271. [2] Shirras, op. cit., p. 681.

[3] Bastable, C. F., *Public Finance* (Macmillan) 1903, p. 235.

[4] See *The Bengal Amusement Tax Act* (V of 1922), sections 14–23.

[5] See *The Bombay Betting Tax Act* (VI of 1925), section 5.

[6] *Annual Budget Reports.*

[7] For 1936–7 the *Report* does not give the yield from the betting tax separately. It is combined with the entertainment tax.

§4. *CONCLUSIONS*

The Burden and Incidence of Taxation

The principal sources of revenue of the United Provinces (which is more or less representative of other Provinces) have now been reviewed in each of their principal aspects, but no attempt has been made to estimate the burden and incidence of taxation. In the present section an attempt will be made to supply this information by examining the tax system of the Government of India as well as that of the Provinces.[1] Before, however, proceeding to the details of such an inquiry, attention must be drawn to the insufficient statistical data which does not enable us to draw any cut-and-dried conclusions regarding the burden and incidence of taxation. But there is a certain amount of both direct and indirect evidence regarding the problem, from which it is possible to draw some broad conclusions.

The one general conclusion to which we have come from the study of the Indian tax system is that *the total burden of taxation in India is not excessive*. This assertion is in harmony with the conclusion arrived at by Dr Anstey that India does not appear to have been obviously overtaxed.[2] The above conclusion, of course, does not imply that the distribution of taxation is satisfactory. *The chief fault of the Indian tax system lies in its unsatisfactory distribution of taxation.* Let us consider a few fundamental facts which show the burden and incidence of taxation in India. An analysis of taxation per head in British India is given in Table XIII.

Taxation per head of the population has risen from Rs. 3–11–4 in 1921–2 to Rs. 3–12–4 in 1935–6, excluding land revenue. Including land revenue, it has fallen from Rs. 5–1–1 in 1921–2 to Rs. 4–14–3 in 1935–6. Hence, the incidence per head has actually fallen in India during the last few years as compared with 1921–2.

Table XIII however does not give a correct view of the

[1] Local taxation is not considered because it is mostly beneficial. See ch. xii.

[2] ANSTEY, *op. cit.*, p. 444.

distribution of the burden of taxation in proportion to income. From the scanty statistical material available in India it is impossible to calculate accurately figures of *per capita* income in India. Moreover, as Dr Anstey has rightly observed, the relative burden of taxation varies greatly in different districts.[1] In order to come to any definite conclusions as to the relative burden of taxation it is necessary to work out a census of production and reorganization of statistics. But no such study has yet been made. Nevertheless, from the broad features of the Indian tax system certain conclusions stand out prominently. It is generally agreed that the burden of direct taxes falls on the richer classes and that of indirect taxes (in a greater proportion) on the poorer classes. The result of dividing Table XIII into two classes of direct and indirect taxes is shown in Table XIV.

Regressive Nature of the Tax System

It would be misleading to draw any definite conclusions as to the existing distribution of the tax burden upon taxpayers at different levels of income from the above percentage of direct and indirect taxes to total tax revenue. Such conclusions are only possible if investigations on the lines of the Colwyn Committee are undertaken in India.[2] Nevertheless, a somewhat detailed examination of the several taxes would give a broad picture of the burden of taxation in India.

[1] ANSTEY, op. cit., p. 444. For *per capita* income see ch. i, p. 18. For differences in the burden of taxation due to land revenue see ch. vii. In ch. xii the inequalities caused in the burden of taxation by local taxation are considered.

A scheme for an economic census of India with special reference to a census of production and reorganization of statistics was drafted by Professor Bowley and Mr D. H. Robertson. See *Bowley-Robertson Committee Report* (1934) Government Press, New Delhi.

[2] The Colwyn Committee calculated the burden of taxation, direct and indirect, on various incomes for the years 1903–4, 1913–14, 1918–19, 1923–4 and 1925–6. The taxpayer was assumed to be a married man with a wife and three children. Among direct taxes the burden of income-tax, super-tax and death-duties was calculated. The burden of indirect taxes such as customs and excise duties, including tobacco, alcoholic drinks, the tea duty, and entertainments duty was calculated on the budgets of household expenditure. See section iii of the *Colwyn Committee Report*, Cmd. 2800 (1927).

No difficulty is involved in allocating the burden of the income-tax. The tax is graduated and increases with the size of the income. Persons below the exemption limit (now Rs. 2,000) are free from the burden. The tax receipts fall wholly on the rich classes. It is very difficult to calculate the distribution of land revenue between zamindars and ryots in permanently or temporarily settled areas and under ryotwari tenures. But it is generally agreed that the incidence of land revenue is light and that of rentals excessive. Broadly speaking we may say that land revenue is a regressive tax and its burden is heavy on the poor cultivators.[1] Thus income-tax is the only direct tax in India which wholly falls on the richer classes. Land revenue, being regressive in character, does not in practice fulfil the distributive functions of a direct tax.

Coming to indirect taxes,[2] the customs revenue may be divided as follows:

	1935–6
Total revenue from Imports	Rs. 39,01,32,048
Total revenue from Exports	4,35,22,988
Excise duty on Motor Spirit	5,32,49,408
Excise duty on Kerosene	2,84,07,803
Excise duty on Sugar	1,58,87,500
Excise duty on Matches	2,02,81,306

It is thought by some that the incidence of export duties, especially on jute, is on foreigners. Theoretically, the incidence of export duties is divided between the importers and exporters in inverse proportion to the elasticities of their respective demands for the goods in exchange. In other words, it is divided in direct proportion to the urgencies of the respective needs which are satisfied by the exchange.[3] In the present conditions of international trade, when other products are being substituted for jute and jute products, the value of India's monopoly of jute has considerably decreased. Hence it is fair to assume

[1] See ch. vii.

[2] We have left out of consideration certain miscellaneous items, e.g. excise duty on silver, etc.

[3] DALTON, *Public Finance*, p. 57.

TABLE XIII

TAXATION PER HEAD IN BRITISH INDIA

(IN THOUSANDS OF RUPEES)

HEADS OF TAXATION	1921-2	1932-3	1933-4	1934-5	1935-6
Customs	34,37,42	51,67,47	46,85,58	52,36,50	53,77,59
Taxes on Income	22,17,54	18,00,31	17,15,89	17,58,04	17,09,95
Salt	5,97,52	9,83,29	8,51,24	7,63,67	8,06,11
Excise	17,03,80	14,64,62	14,74,32	14,81,57	15,03,76
Stamps	10,88,06	12,91,97	12,24,43	12,02,47	11,82,90
Registration	1,13,55	1,13,49	1,12,66	1,17,14	1,18,06
Scheduled Taxes	...	41,19	40,66	44,73	45,91
Total (excluding Land Revenue) ...	91,57,56	1,08,62,36	1,01,04,80	1,08,04,14	1,07,44,31
Land Revenue	33,55,56	30,61,06	29,74,27	32,04,68	31,92,22
Total (including Land Revenue) ...	1,25,13,48	1,39,23,43	1,30,79,07	1,38,08,83	1,39,36,54
Payment per head assuming that the whole taxation is paid by inhabitants in British India:	Rs. A. P.	Rs. A. P.	Rs. A. P.	Rs. A. P.	Rs. A. P.
(i) Exclusive of Land Revenue ...	3 11 4	3 14 9	3 9 10	3 12 1	3 12 4
(ii) Inclusive of Land Revenue ...	5 1 1	5 0 6	4 10 10	4 14 3	4 14 3

SOURCE: *Statistical Abstract for British India*, 1938, p. 514.

TABLE XIV

DIRECT AND INDIRECT TAXATION

(IN THOUSANDS OF RUPEES)

HEADS OF REVENUE	1921-2	1932-3	1933-4	1934-5	1935-6
1. *Direct Taxes*—					
Taxes on Income	22,17,54	18,00,31	17,15,89	17,58,04	**17,09,95**
Land Revenue	33,55,56	30,61,06	29,74,27	32,04,68	**31,92,22**
Total ...	55,73,10	48,61,37	46,90,16	49,62,72	**49,02,17**
2. *Indirect Taxes*—					
Customs	34,37,42	51,07,47	46,85,58	52,36,50	**53,77,59**
Salt	5,97,52	9,83,29	8,51,24	7,63,67	**8,06,11**
Excise	17,03,80	14,64,62	14,74,32	14,81,57	**15,03,76**
Stamps	10,88,06	12,91,97	12,24,43	12,02,47	**11,82,90**
Registration	1,13,55	1,13,49	1,12,66	1,17,14	**1,18,06**
Scheduled Taxes	...	41,19	40,66	44,73	**45,91**
Total ...	69,40,35	90,62,03	83,88,89	88,46,08	**90,34,33**
Percentage of direct taxes to the total tax revenue	44·54	34·92	33·86	35·94	**35·18**
Percentage of indirect taxes to the total tax revenue	55·46	65·08	64·14	64·06	**64·82**

that a portion of the jute export now falls on the producer. The excise duty on motor spirit falls exclusively on the richer and commercial classes. In the absence of any reliable evidence as to the consumption of kerosene oil, sugar and matches at the specified levels of income, we may say that the duty on kerosene is mostly paid by the poorer class, that on sugar mostly by the middle class, and on matches by the poor, middle class and rich in proportion to their numerical strength; the aggregate amount taken as a whole comes largely from the poorer section.

In the import schedule all duties on ale, beer, spirits and liqueurs, wines, spices, tea, tobacco, motor spirit, oils, boots and shoes, motor-cars, electric bulbs, wireless reception instruments, pneumatic tyres, cotton fabrics of British manufacture, silk fabrics and artificial silk fabrics, are mostly paid by the richer classes. The total receipts from these items during 1935–6 amounted to Rs. 11 crores. Duties on kerosene oil, sugar and cotton fabrics of non-British manufacture fall more heavily on the poorer classes. The total receipts from these were Rs. 8 crores. Thus in the total import revenue of Rs. 39 crores, Rs. 11 crores fell distinctly on the richer classes, and Rs. 8 crores on the poorer classes. The burden of Rs. 20 crores on miscellaneous goods (e.g. certain types of machinery, steel goods, railway plant, rolling stock, etc.), cannot be definitely distributed.

The salt tax has been bitterly opposed on the score that as it falls on a necessity of life it imposes an undue burden on those who are least able to contribute anything towards the State expenditure. It is defended by the argument that salt is the only universally consumed commodity by which the State can tax the poorest classes in the country.[1] The burden of the tax may be exaggerated; nevertheless it cannot be denied that it is the most regressive tax in India and the largest portion of it is paid by the poorer classes.[2] The present rate of duty (Re. 1-4 per maund) should not be increased except at a time of urgent financial stress.[3]

[1] See ch. iv, p. 89.

[2] The rate of duty was increased in 1926 to Rs. 2-8 per maund. The revenue from the import of salt is included under this heading and not under customs.

[3] ANSTEY, op. cit., p. 378.

The revenue from excise (consisting mostly of the proceeds of duties on country spirit) is borne by the poorer classes.

The revenue from stamps and registration cannot properly be allocated according to the size of income. Nevertheless, as the Colwyn Committee observed (referring to stamp duties), these fall mainly on the better-off classes.[1] In the case of scheduled taxes (which consist in India of amusement and betting taxes) the burden falls on the middle and rich classes.

From this brief analysis of the sources of revenue of the Government we can only conclude that, though India is not over-taxed, the relative burden of taxation is heavier on the poorer than on the richer classes. On the whole, as argued in the previous chapters, the best way to lighten the burden of the masses is to reduce rentals and to place more reliance on direct taxes.[2] We may also state, without entering into the controversy, that any extensive application of protection for the industrial development of the country is bound to be at a very heavy cost to consumers in general.[3]

[1] The Colwyn Committee in calculating the burden of taxation did not take stamp duties into consideration. Such duties, they observed, 'are mostly levied on occasional transactions of irregular frequency and have no clearly definable relation to the annual income of the individual'.—*Report*, p. 75.

[2] See chs. vii, viii and ix.

[3] ANSTEY, op. cit., p. 354.

X

PROVINCIAL EXPENDITURE

§1. *EXPENDITURE ON LAW AND ORDER*

Introductory

The trend of the financial resources and the machinery of their administration have been reviewed in the previous chapters,[1] but no attempt has been made to estimate the effects of the expenditure on the conditions of life of the people.[2] The present chapter will deal with the expenditure policy of the Government, and its results. The plan of the chapter will be as follows. In the first place the expenditure on law and order will be analysed. Secondly, an account will be given of the effects of expenditure on the nation-building departments. Thirdly, while discussing the adequacy of the policy pursued by the Government, the fundamental obstacles to improvement will be laid bare. Finally, it will be suggested that the present stagnation of the resources of the Province can be somewhat relieved by improving agriculture and developing cottage industries.

Expenditure on Law and Order

Provincial expenditure under the Reforms was sharply divided into two broad categories, namely (i) expenditure on law and order and (ii) expenditure on development departments. While the expenditure on the former was reserved that on the latter was transferred.[3] The expenditure on law and order in the United Provinces during the period 1921–39 is shown in Table XV: this table gives the figures of gross expenditure.

[1] See chs. vi, vii, viii, ix.

[2] It is curious that though social expenditure is the natural starting-point for an investigation into the effects of public expenditure (Hicks, op. cit., p. 36) no writer on provincial finance in India has discussed this aspect of the problem.

[3] See chs. iii and vi.

An idea of the net expenditure can be obtained from the following summary relating to the year 1933–4:

Administration of Justice
Gross expenditure Rs. 69 lakhs.
Net „ 58

Jails and Convict Settlements
Gross expenditure Rs. 31 lakhs.
Net „ 26

Police
Gross expenditure Rs. 1,61 lakhs.
Net „ 1,58

It is not necessary to analyse these figures in great detail; but one conclusion is apparent from Table XV. The expenditure on general administration, administration of justice, jails and convict settlements and police was practically the same in 1939–40 as it was at the beginning of the Reforms. Two complaints, however, were urged against this expenditure: (i) it was not subject to the vote of the Council; and (ii) it was higher than the expenditure on development departments. The answer to the first objection has already been given in chapter vi.[1] No doubt the expenditure on law and order was higher than on development departments; but before jumping to the conclusion that injustice was done to the development departments it is to be observed that the amenities of life and the advancement and development of nation-building services depends to a large extent on the standard of services rendered by the Government under law and order. Security of life and property and the administration of justice are the first essentials of good government. That these conditions were fulfilled can hardly be challenged by any critic whatever be his political prepossessions. Moreover, it must be admitted that the expenditure on development departments was low at the beginning of the Reforms.[2] The growth of expenditure on development departments is given in Table XVI. The slow growth was much resented by the public. The bad finances of the Province were solely responsible for this state of affairs. To this we shall return in chapter xi. The next section analyses in detail the effects of expenditure on development departments.

[1] See pp. 138–9. [2] See ch. xi.

TABLE XV

EXPENDITURE ON LAW AND ORDER (RESERVED) (GROSS)

(IN LAKHS OF RUPEES)

HEADS	1921-2	1922-3	1923-4	1924-5	1925-6	1926-7	1927-8	1928-9	1929-30	1930-1
General Administration	1,38	1,37	1,29	1,29	1,32	1,34	1,35	1,39	1,40	1,41
Administration of Justice ...	66	67	68	69	71	75	75	75	78	77
Jails and Convict Settlements ...	34	39	31	30	35	38	37	39	42	42
Police	1,67	1,73	1,60	1,62	1,63	1,64	1,68	1,69	1,71	1,79
Total ...	4,05	4,16	3,88	3,90	4,01	4,11	4,15	4,22	4,31	4,39

HEADS	1931-2	1932-3	1933-4	1934-5	1935-6	1936-7	1937-8	1938-9[1]	1939-40[2]
General Administration ...	1,32	1,25	1,28	1,32	1,37	1,50	1,43	1,44	1,50
Administration of Justice ...	73	67	69	69	70	71	71	70	73
Jails and Convict Settlements ...	29	31	31	31	31	30	31	30	32
Police	1,70	1,58	1,61	1,62	1,62	1,68	1,65	1,67	1,67
Total ...	4,04	3,81	3,89	3,94	4,00	4,19	4,10	4,11	4,22

[1] Revised estimate. [2] Budget estimate.

ROUGH GRAPHICAL NTATION OF TA

TABLE XVI

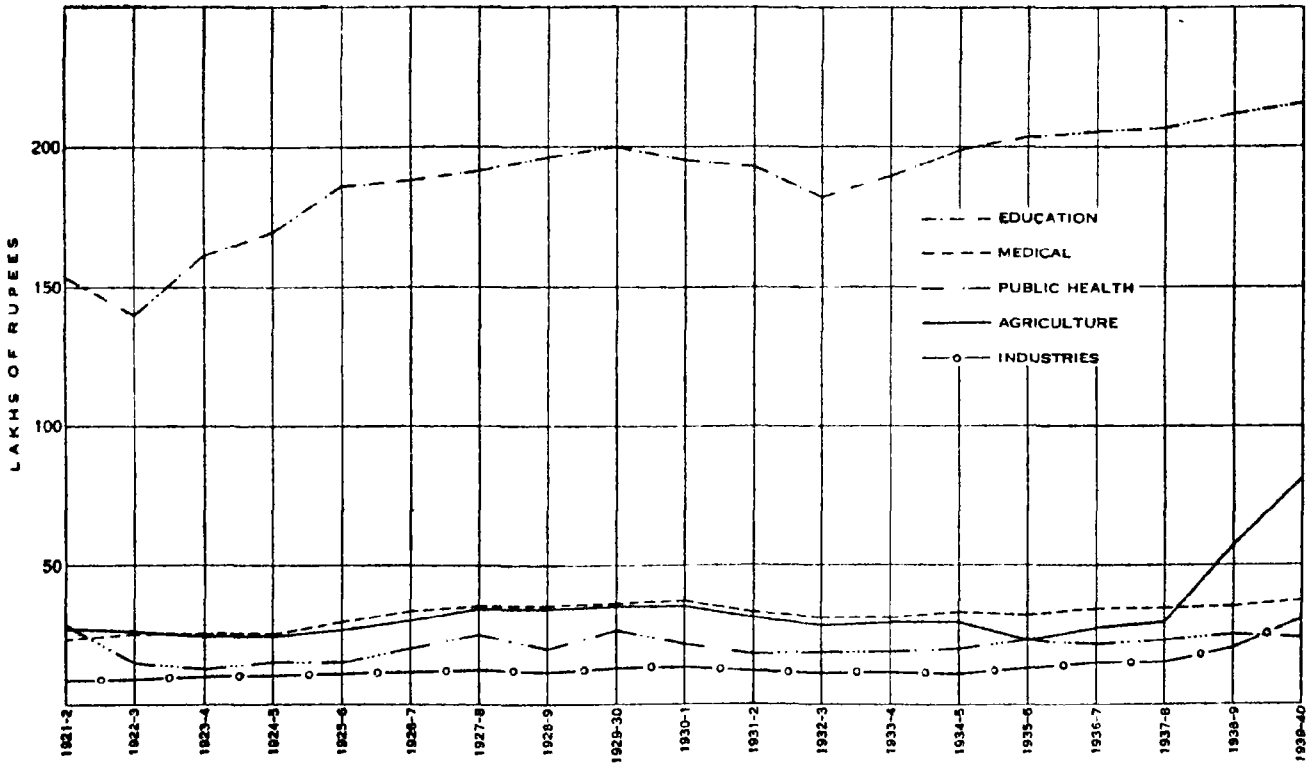
EXPENDITURE ON DEVELOPMENT DEPARTMENTS (TRANSFERRED) (GROSS)

(IN LAKHS OF RUPEES)

HEADS	1921-2	1922-3	1923-4	1924-5	1925-6	1926-7	1927-8	1928-9	1929-30	1930-1
Education ...	1,52	1,39	1,59	1,70	1,85	1,87	1,92	1,96	2,00	1,95
Medical ...	23	25	25	25	29	33	35	35	36	37
Public Health ...	29	16	13	16	16	22	25	22	27	23
Agriculture ...	27	26	24	24	27	30	34	34	35	35
Industries ...	9	9	10	10	11	12	13	12	14	14
Total ...	2,40	2,15	2,31	2,45	2,67	2,84	2,99	2,99	3,12	3,04

HEADS	1931-2	1932-3	1933-4	1934-5	1935-6	1936-7	1937-8	1938-9[1]	1939-40[2]
Education ...	1,93	1,83	1,90	2,00	2,02	2,05	2,06	2,11	2,15
Medical ...	33	31	31	33	32	34	34	35	37
Public Health ...	19	19	19	20	23	22	23	25	24
Agriculture ...	31	28	29	29	23	27	29	57	81
Industries ...	12	11	11	10	12	15	15	20	30
Total ...	2,88	2,72	2,80	2,92	2,92	3,03	3,07	3,48	3,87

[1] Revised estimate. [2] Budget estimate.



ROUGH GRAPHICAL REPRESENTATION OF TABLE XVI

§ 2. *EXPENDITURE ON DEVELOPMENT DEPARTMENTS*

The category of provincial expenditure showing the largest expansion in the period 1921–40 consists of services which can conveniently be grouped under the heading of nation-building departments. The items included under this heading are education, medical, public health, agriculture and industries. In Table XVI an analysis is given of the trend of expenditure under each head over the period. An idea of the net expenditure may be gained from the following summary relating to the year 1933–4:

Education
Gross expenditure Rs. 1,90 lakhs.
Net ,, 1,78

Medical
Gross expenditure Rs. 31 lakhs.
Net ,, 28

Public Health
Gross expenditure Rs. 19 lakhs.
Net ,, 17

Agriculture
Gross expenditure Rs. 29 lakhs.
Net ,, 24

Industries
Gross expenditure Rs. 11 lakhs.
Net ,, 9

Certain explanations are necessary. First, the figures relate to provincial expenditure only. The expenditure of local authorities on these services is kept apart. Secondly, the expenditure includes all expenditure, recurring or non-recurring. Thirdly, the income from the department is not deducted from the expenditure.

The table points, first, to the growth of expenditure during the period from Rs. 2,40 lakhs in 1921–2 to Rs. 3,87 lakhs in 1939–40. The expenditure is highest during 1939–40. Second, the expenditure on education has increased much more than on any other head. Third, the expenditure on public health has varied enormously in different years, ranging from 29 lakhs in 1921–2 to 13 lakhs in 1923–4. A separate examination of the

expenditure on each service is, however, necessary. In doing this, the services will receive our attention in the order of their importance from the point of view of expenditure.

(i) Education

The service ranking first is education. The expenditure on education has strikingly increased from Rs. 1,52 lakhs in 1921 to Rs. 2,15 lakhs in 1939–40.

It may be interesting to compare the proportion of educational expenditure to total provincial revenue in the United Provinces with that of the major Provinces in India. This is done in the following table. The population figures (1931) in millions are also added.

Provinces	Population in millions	Revenue in crores	Educational expenditure from Government funds in crores	Expenditure per 1,00 of population	Percentage of educational expenditure from Government funds to total revenue
Madras ...	46·7	Rs. 16·29	Rs. 2·55	Rs. 55	16
Bombay ...	21·8	12·03	1·76	81	15
Bengal ...	50·1	9·79	1·36	27	14
United Provinces	48·4	11·89	2·02	42	17
Punjab ...	23·6	11·41	1·6	68	14
Bihar and Orissa	37·7	5·54	0·53	14	10[1]

It is apparent from the table that the United Provinces Government was spending the highest percentage on education among the major Provinces in India. Expenditure per head was, however, highest in Bombay. Since the figures in the table relate to education as a whole, it is desirable to consider the various branches separately. We consider Primary education first.

[1] See *General Report on Public Instruction in the United Provinces for the quinquennium ending March, 1937*, p. 69.

Primary Education

Primary education is mainly the concern of local authorities. District boards and municipalities are responsible for its administration and the provision of schools in their areas is under their control.

The expenditure on primary education from the various sources is given in the table below:

Heads	1931-2	1936-7
	Rs.	Rs.
Provincial Revenue	59,84,201	58,07,930
District Board Funds	18,57,447	18,16,160
Municipal Board Funds ...	6,09,911	6,52,844
Fees	2,69,046	3,09,782
Other Sources	1,67,468	1,96,167
Total ...	88,88,573	87,83,883

The number of boys of the primary school age of 6 to 11 years, estimated at 12 per cent of the male population, is 3,053,400 (1931). The total number of girls, between the same age, is 2,755,650. Actually the number of boys and girls attending a primary school was 1,201,540 (37 per cent) and 164,407 (5 per cent) respectively in 1937. These figures, however, do not reveal the true picture. There is enormous wastage in both boys' and girls' education. Out of every hundred children who enter a primary school in the Infants class only 27 reach Class III, which is the earliest age when children can acquire permanent literacy. An idea about the wastage in education in boys' and girls' schools can be gained from the following figures. The table shows the incidence of wastage in different classes in boys schools:[1]

Year	Infants	Class I	Class II	Class III	Class IV
1931-2 ...	44·3	22·4	14·39	10·8	7·9
1936-7 ...	41·4	23·8	14·6	11·6	8·6

[1] See *General Report on Public Instruction in the United Provinces, 1937* (issued 1938).

The table below shows the wastage in girls' primary schools:[1]

Number of Girls in				Proportion in	
Infant Class	Class I	Class II	Class III	Infant Class	Class III
1933–4	1934–5	1935–6	1936–7	1933–4	1936–7
112,165	35,994	21,891	13,341	100	11·95 per cent

This is a very serious matter. Apart from other causes, such as bad teaching and illness, the main causes for stagnation in primary schools may be grouped into two classes, (i) administrative and (ii) economic. The United Provinces is a Province of small villages. There are 105,640 villages in the Province, but only 28,000 villages have a population of over 900, which is sufficient to support a full primary school. Consequently 40 per cent of the primary schools are preparatory and end with Class II. This explains the difficulty of extending primary education in small villages.

Another important problem in primary education is that of relapse into illiteracy. Children who acquire literacy at the age of ten, on account of environment, relapse into illiteracy. The explanation of such relapse is simple: the parents in the village home are usually illiterate, they are too poor to buy books, and attractive vernacular literature and periodicals suitable for children are not available.[2] Thus even those who are literate at an early age become illiterate at a later age.

Economic factors are responsible not only for the disastrous wastage, stagnation and relapse into illiteracy but also for the small percentage (37 per cent) of the children of primary school age attending schools at all. For this state of affairs the composition of the population is partly responsible. It is estimated that 26 per cent of the population belongs to the Depressed Classes. They are so poor that they cannot afford to lose the small earnings of their children's services, even at the age of ten. In addition to the Depressed Classes the majority of the poorer tenants cannot spare their children from field work.

[1] ibid. [2] See Cmd. 3407 (1929), p. 49.

The conclusion is obvious. Until the standard of life of the greater proportion of the population is raised it is difficult to expect much improvement in the figures of primary education. It is a vicious circle. The standard of life cannot be easily raised as the people are illiterate. Hence for a permanent advancement of education it is essential that we must remove some of the main obstacles to more rapid economic progress of the country.[1] Meanwhile the movement for a free compulsory education, opening of more night schools and starting of co-education at the primary stage will remove some of the administrative difficulties and make a way for progress.

Secondary Education

Secondary education is composed of two systems, the Anglo-Vernacular system and the Vernacular system. The medium of instruction in both systems is the vernacular but in the former case English is studied. In secondary education definite progress has been achieved during the period. The outstanding feature of secondary education in the period has been the progress of the Board of High School and Intermediate Education. The Board began to function in 1922 and has had a marked effect on secondary education in the Province. The number of high schools and intermediate colleges has multiplied. The high school examination list rose to 17,610 in 1940–1. The enrolment has also considerably increased in middle and vernacular schools. The expenditure from the different sources on secondary education is given in the following table:

Heads	1931–2 Rs.	1936–7 Rs.
Provincial Revenues	47,59,854	53,21,977
District Board Funds	3,25,890	3,53,394
Municipal Board Funds ...	1,92,150	2,59,371
Fees	28,50,791	33,88,085
Other Sources	7,86,617	9,93,600
Total ...	89,15,302	1,03,16,427

[1] See chs. i and xiii.

The problem of the reorganization of secondary education so as to minimize its effect of educated unemployment has been studied from various points of view. The Government appointed the Unemployment Committee under the chairmanship of Sir Tej Bahadur Sapru to suggest methods to make secondary education more practical. The three serious defects in secondary education are that:

(i) it is of an excessively literary bent, and tends to create an anti-vocational bias;
(ii) it is dominated by formal courses and examinations; and
(iii) it is top-heavy.

The discussion of this aspect of the problem lies outside the scope of this work.

University Education

The university education of the Province is in the control of five universities, three of which are provincial institutions. The Benares Hindu University and the Aligarh Muslim University receive grants from the Government of India. The three universities of Allahabad, Lucknow and Agra and the affiliated colleges received the following recurring grants in 1931–2 and 1936–7:

	1931–2	1936–7
Allahabad	6,43,966	7,63,489
Lucknow	8,55,080	8,76,934
Agra	50,400	68,400
Affiliated Colleges	4,47,542	5,50,597

Summary and Conclusion

To summarize, expenditure on education has substantially increased in the period 1921–40. Out of the provincial revenues, approximately 11 per cent is spent on university education, 26·5 per cent on secondary education and 29 per cent on primary education. The percentage of literacy in the Province is very low. The number of male and female literates per mille of total male and female population is 80 and 10 respectively (1931). The cost per annum of educating a boy in a vernacular primary school is put at Rs. 7–4–11. At this rate it

would require an additional sum of Rs. 1,35,42,726 recurring, per annum, to give primary education to all boys of school-going age. Keeping the same figure in the case of girls the additional cost of educating all school-going girls would be approximately Rs. 2,03,30,328. The total additional cost would amount to approximately Rs. 3,78,73,054. This figure does not take into consideration the amount which would have to be expended on buildings, equipment and the training of teachers. The present annual revenue of the Province is Rs. 11·89 crores. The educational budget is Rs. 2,07,53,108 (1937). If to this amount the cost of educating all boys and girls is added, the total educational expenditure would be about 5·85 crores.

From the above facts the conclusion cannot be avoided that before any further burden is thrown on the provincial revenues certain conditions must be fulfilled. The whole education policy needs overhauling. A different type of rural education, indeed of primary and secondary education in general, is absolutely essential for more efficient and scientific production, as well as in order to change the social ideals of the people.[1] Until this problem is seriously attacked, not much success can be achieved by more expenditure. Secondly, local authorities must rise to the responsibility of bearing a larger share of future educational expenditure. Thirdly, voluntary effort, in the shape of free services or contributions, must be directed in helping local bodies to introduce the principle of compulsory education. Lastly, it must be remembered that the educational system of India cannot be put on a better footing unless more attention is directed to women's education. The whole future of India largely depends upon woman's education, for it is she who rules the family. Even those who maintain that the female is the weaker sex would do well to remember that the strength of a chain depends upon its weakest link.[2]

(ii) Medical and Public Health

The services ranking next in importance as a cause of increased outlay are medical and public health. Perhaps after the expenditure on primary education no other expenditure

[1] Anstey, op. cit., p. 480. [2] Anstey, op. cit., p. 481.

can contribute more to increase the income of the community than the expenditure upon public health and medical relief. The economic loss due to a low standard of health and the prevalence of epidemic diseases such as malaria, hook-worm, influenza, cholera and kala-azar, though it cannot be calculated in figures, is obviously the most important factor in the arrested economic development of India. When millions of the population are incapable of working for a considerable part of the year, on account of the common epidemics mentioned above, the output per head must be low. It need hardly be emphasized that expenditure on public health and medical relief, apart from securing beneficial social results, will ultimately be remunerative financially. As Dr Anstey has put it, 'Even when not directly profitable, such expenditure, if wisely directed, inevitably enhances productivity, restricts waste, and increases the taxable capacity of the people. This aspect of the public health movement is frequently ignored, and, indeed, it is seldom that expenditure on public health is so much as mentioned in connexion with economic policy. Actually the conquest of India's preventable diseases would bring far greater economic gain than any number of commercial, industrial or financial reforms.'[1]

Review of Public Health Services

A review of the public health movement in the Province brings out the following salient features. The population of the United Provinces, according to the census of 1931, is 48,408,763, and on this figure the provincial birth and death rates shown below are based. The birth and death rates of the Province for 1936 and 1935, and the quinquennial average figure, are shown in the following statement:[2]

	PER MILLE OF POPULATION	
	Birth rate	*Death rate*[2]
1936 ...	38·99	22·61
1935 ...	36·04	24·78
Average, 1931–6	36·45	23·88

[1] See ANSTEY, op. cit., p. 67.

[2] *Annual Report of the Director of Public Health, United Provinces, 1936.*

The death rate in 1936 from all causes showed a decrease of 2·17 as compared with the figures of the preceding year. A comparative statement showing the death rate from certain diseases is appended below :[1]

Chief causes of mortality	Death rate per mille for 1936	Average death rate 1926–35	+ increase or − decrease as compared with decennial average
Cholera	0·14	0·60	− 0·46
Small-pox	0·30	0·22	+ 0·08
Plague	0·15	0·72	− 0·57
Fever	17·60	18·44	− 0·84
Dysentery and			
Diarrhœa	0·34	0·36	− 0·02
Respiratory diseases ...	0·89	0·77	+ 0·12
Injuries	0·44	0·44	
All other causes	2·75	2·77	− 0·02
All causes	22·61	24·29	− 1·68

Public Health and Epidemics

The most important development of the public health activities in the Reforms period was its extension to rural areas. In 1920 the Government started the district health scheme under which each district is placed under a medical officer of health with a number of travelling dispensaries under his charge. The primary object of the district health scheme is to combat epidemics. It is also to facilitate solving the problems of rural sanitation. Under the department's policy the devastating effects of cholera and plague are greatly lessened and controlled. There is adequate organization of vaccination establishments in both rural and urban areas, so that small-pox epidemics are almost unheard-of. Arrangements are in force whereby in the non-epidemic season the public health staff is employed to educate the masses by constant propaganda in personal and domestic hygiene. To give a realistic picture, films illustrating the real causes of diseases are shown. The department has also paid a good deal of attention to the improvement of rural water-supplies by disinfecting the village wells with permanganate of

[1] See ibid.

potash. In some cases, with the help of district boards, model wells (made by closing the tops of wells and installing pumps) have also been constructed.

In the field of rural sanitation, prevention of epidemics, vaccination and collection of vital statistics, the services of village *panchayats* should be made use of. As the services are of a purely local nature which should benefit the residents of the village the co-operation of *panchayats* with the public health department and the district boards would cheapen the cost and increase efficiency of administration.[1]

Public Health and Local Authorities

One important point demands attention at this stage. The major portion of the expense on public health activities was provided by the Provincial Government. The boards did not provide additional funds; 'they have in fact been unwilling to pay for progress; they have also failed to co-operate with Government and to make the most use of the highly skilled staff placed at their disposal by Government'.[2] Public health activities are such that it is essential that, in order to ensure a reasonably efficient administration so as not to endanger the health of people living in other districts, the Government should have sufficient control over them. Under the provisions of the District Boards and Municipalities Act in the Province these bodies possess more powers and independence than similar bodies in England. The best way to increase the control of the Provincial Government and to place a greater burden of responsibility on local authorities is to start the system of grants-in-aid under which each local authority must provide a minimum towards the expense of public health services. The Provincial Government in providing its portion of expenses would see that certain essential measures were carried on in a reasonably efficient way. To provide the minimum, the local authorities should develop local sources of revenue, if need be.[3]

[1] See ch. xii.
[2] See *Report of the Indian Statutory Commission*, Vol. IX, p. 432.
[3] See ch. xii.

Medical Department

The medical work of the Province consists of a large number of general hospitals, rural dispensaries, and two medical colleges. Besides, the Government has taken definite steps to aid and encourage *ayurvedic* and *unani* systems of medicine.[1] Travelling dispensaries were opened in rural areas to extend facilities for medical treatment on western lines.[2]

The work of medical aid is closely bound up with local self-government. At headquarters of districts the Government maintains *sadar* hospitals. Some of the municipalities have also opened dispensaries. In rural areas the provision of medical aid is highly unsatisfactory. The Government maintains travelling dispensaries and hospitals at important places in districts. Besides this the Government started two new schemes of relief:

(i) It undertook to grant to local bodies or to private persons, or to both together, grants amounting to one-half of the cost, initial and recurring, of any new dispensary opened in rural areas.

(ii) It has subsidized registered medical practitioners who took up practice in rural areas. The subsidies amounted to Rs. 600 per annum for a graduate in medicine and Rs. 400 for a sub-assistant surgeon.

The results of both schemes, however, have been disappointing.[3]

Medical Aid and Local Authorities

The main reasons for the discouraging results is that local bodies in India have so far not realized their proper

[1] In the first seven years of the Reforms the Government spent on these systems Rs. 7 lakhs, of which Rs. 1·30 lakhs were non-recurring. In 1936–7 the provision was distributed as follows:

For development of Indigenous Systems of Medicine	Rs. 49,319
For *Ayurvedic* and *Unani* State-aided Schools and Colleges	1,08,067
For Board of Indian Medicine	9,754
Total	Rs. 1,67,140

See United Provinces Budget, 1938–9.

[2] There were 698 hospitals and dispensaries of all classes at the commencement of the year 1936 and 691 were functioning at the close of the year.

[3] See *Report of the Indian Statutory Commission*, Vol. IX, p. 407.

place in the administration of onerous services. They have not attempted to develop local sources of revenue. They expect Provincial Governments to provide all the facilities for the development of local services. This is evidenced by the attitude of district boards since 1922 when the boards were released from official control. With the change in position of the boards, hospitals and dispensaries are steadily deteriorating both in fabric and equipment because the boards cannot or will not find the money to keep them in repair and properly equipped, and because local subscriptions have largely decreased where they have not altogether disappeared.[1] Here again the only way to extend medical aid is to start a system of grants-in-aid in which district boards should provide a part of the funds for rural dispensaries and municipal boards for urban dispensaries.[2]

Lack of Voluntary Help

A lamentable feature of Indian social life is that charitable contributions and donations for medical aid (or for any other service) are conspicuous by their absence. The small contributions from local and municipal boards and the apathy of the public throw too heavy a burden on the State. No State, however good its finances may be, can rapidly develop such services unless substantial material help is forthcoming from local authorities and the public. Unfortunately public charity in India is misdirected; it is mostly used for religious purposes which do not advance those aspects of life which would promote the material prosperity of the country. Voluntary contributions and public charity form a very substantial part of the income of hospitals and educational institutions in England. Unless public help is forthcoming it is impossible to expect a more rapid development of the country. Where is the Indian Nuffield who will educate the children and relieve misery and suffering among the masses?[3]

Medical Relief for Women

The provision of medical relief for women is controlled by the Countess of Dufferin's Fund to which the Provincial Government makes large contributions. The Government in

[1] ibid., p. 408 [2] See ch. xi. [3] See ch. xiii.

1931–7 granted Rs. 1,59,093 aid to the Dufferin Funds. The Lady Chelmsford League controls maternity and child-welfare work and trains midwives and *dais*. Midwives, *dais* and health visitors instruct mothers in the care of infants. The outstanding example of the good work done by the League is shown in a steady downward tendency in infantile mortality since 1921. This is evident from the following statement:

INFANTILE MORTALITY PER THOUSAND OF BIRTHS
UNITED PROVINCES

Year	Infantile mortality		Total
	Male	Female	
1921	240·6	232·1	236·5
1922	189·6	177·3	183·8
1923	174·2	163·9	169·4
1924	198·1	185·1	192·0
1925	179·4	171·1	175·5
1926	183·3	170·6	177·3
1927	156·9	145·9	151·7
1928	165·9	153·1	159·9
1929	173·4	163·2	168·6
1930	177·1	163·7	170·8
Decennial average 1921–30	183·8	172·6	178·5
1931	185·6	171·7	179·1
1932	169·2	155·5	162·7
1933	142·5	132·6	137·9
1934	192·1	176·2	184·6
1935	161·6	152·2	157·2
1936	155·6	140·5	148·5

Here, as elsewhere, there is considerable opposition to the good work of the movement due to ignorance, superstition, prejudice and distrust.

Lt.-Col. C. L. Dunn, the Director of Public Health, United Provinces, in an article on the 'Economic Value of the Prevention of Disease', concluded that 'money spent in training midwives, health visitors, and *dais* under the supervision of Medical Officers of Health in towns, would undoubtedly reduce by half the existing death-rate of infants'. He estimated that an

expenditure of two annas per head of population per annum would ensure an organization capable of attending all the children in towns and supervising them during the first month of life.[1] As a considerable proportion of the infantile death rate is due to unhygienic social customs, intensive propaganda, carried on with a view to breaking down the prejudices of the people and creating a demand for the service of a better class of *dais* than at present, would undoubtedly reduce the existing death rate. It is true that the expenditure would not bring in any direct return, but the indirect benefit of the reduction of the appalling infantile mortality would obviously be enormous.

Summary and Conclusion

In conclusion it can be said that the progress in medical and public health services has been one of gain to individual beneficiaries and to the community as a whole. From the point of view of individual beneficiaries a larger measure has gone to the poor. This is evident by the fact that the incidence of infectious diseases like plague or cholera is heavier in conditions of poverty. Moreover, the increased expenditure on hospitals and dispensaries is designed to benefit poor people. The expenditure on maternity and child welfare mainly benefits the poor. The expenditure on these services therefore adds considerably to the welfare of the poorer classes. From the national point of view the utility of these services is obvious. Without unnecessarily duplicating what has already been said, it may be remarked that greater attention to health increases both capacity and will to work. This in turn increases the national dividend. One word needs to be added about the expenditure on medical and public health. The Government of India is no more able to prescribe the conditions under which the people should lead a healthy life than is the Government of any other country. The ultimate eradication of the causes of heavy mortality and the prevention of epidemics rests with the people. It is often ignored that no amount of improvement of medical aid and public health service will improve the lot of the people unless there is co-operation between the authorities and the

[1] See DUNN, C. L., 'The Economic Value of the Prevention of Disease,' *Indian Journal of Economics*, January 1924, pp. 138–9.

public. A crop of archaic customs and superstitions, a blind belief in an inexorable fate, and the ignorance, apathy and neglect of the people, present the greatest obstacles to the improvement of the public health movement in India. It would be a gross exaggeration to say that the present unhealthy condition in which people live is due to the financial stringency of the Government. The most essential condition to procure far-reaching results is a popular revolt against unhygienic habits of life. In it alone lies the hope of amelioration.

(iii) Agriculture

Difficulties in Agricultural Improvement

In chapter vii we have seen that land revenue is the mainstay of provincial finance. Land revenue depends upon 'the prosperity of agriculture', by which we understand financial profits to those carrying on the industry. Agriculture in India, although commercial crops are gradually being introduced, is conducted on primitive lines and the bulk of the crops is still raised for local consumption. The subsistence agricultural policy which worked well for many centuries is now out of place in the new economic organization which regards agriculture as a business. The whole movement towards improved agriculture, scientific research and experimentation, vigorously pursued by the Government, has been associated with this new phase of commercial farming. But owing to the lack of energy and interest on the part of the landholding classes much success has not been achieved. The Indian ryot, on account of poverty, illiteracy, superstition and prejudice 'cultivates by rule of thumb'.[1] The general result of such stereotyped organization has been that agricultural production in India is very low as compared with other countries, and instead of a prosperous we have a depressed agriculture.

Land Revenue not the Cause of Poverty[2]

These difficulties have profoundly affected the yield from land revenue. In discussions on problems of land revenue this aspect of the question is ignored. Why, it may be asked, is

[1] Anstey, op. cit., p. 158. [2] See ch. vii.

land revenue not so prolific in its yield now as it was in the last half of the nineteenth century? The answer is obvious. One of the outstanding reasons for the deterioration in the relative importance of land revenue to total tax revenue of India is that the productivity of the soil has been considerably exhausted and any increase in assessment is keenly felt by the cultivating classes.

Without being pedantic, we may say that the popular belief that a reduction of land revenue would be a panacea for all agricultural ills is based on mistaken ideas. The primitive methods of production, the archaic social customs and institutions and the torrential growth of population are more responsible for the poverty of the cultivating classes than the pressure of land revenue.[1] The stagnation of this source of revenue can only be removed by introducing new ways of promoting agricultural progress.

Agriculture and State Policy

The income from land, in an agricultural country, will always form the greater part of provincial revenue. The future growth of land revenue necessarily depends upon improvements of methods of production. It is not possible here to discuss the defective methods of production. Broadly speaking, it may be said that the three main aspects to which the Government has devoted its attention are (i) to improve the technique of production, (ii) to provide better credit facilities and (iii) to improve methods of marketing agricultural produce.

It can undoubtedly be said that the foundation of agricultural progress depends upon the use of improved implements, seeds and manure. The Department of Agriculture of the United Provinces issued improved seeds in 1936 of all kinds to the total of 42 lac maunds, of which about 39·5 lac maunds was sugar-cane. The limit of the possibilities of departmental seed distribution has been reached as the issue of seed in small quantities to large numbers of scattered cultivators precluded all possibility of effective supervision of the purity of the crop in the field or on the threshing floor. Moreover, often the

[1] See ch. i.

grower did not keep reserve seed for his further sowing but relied on the seed stores for fresh supplies. To avoid these difficulties the department adopted the practice of free exchange of pedigree seed for the local produce and other devices. Under the rural development scheme the distribution of seed by free exchange opens the way to a great expansion of this method.

The extent to which crops respond to better manures is not generally realized. The cane produce in the Province is between 325 and 400 maunds per acre. This, it is said, is at least 50 per cent lower than could be obtained by the use of organic manure materials already at the disposal of the cultivator; 'and a hundred per cent less than he should get with the rational use of concentrated fertilisers'.[1]

The supply of farmyard manure is depleted by the use of dung-cakes for fuel. It is held on high authority that the cultivator can ensure a high standard of fertility in his fields if the quantity of plant refuse by way of crop residues, weeds, leaves, jungle grass and the like which now goes to waste is converted into compost and utilized as manure. 'This holds more possibilities for the economic improvement of the cultivator even than better seeds or implements; and is vital to the . . . maintenance of the agricultural prosperity of the Province.'

The number of modern implements in use is fast increasing. During 1936 complete ploughs and iron parts, such as Meston and Gurjar, totalled over 10,000. This shows that the cultivators are appreciating light metal ploughs and improved machinery.

To summarize: as any general increase in price levels of agricultural produce in the near future is highly problematical, it is essential that relief to the cultivators from the present straits should be secured by increasing the quantity and quality of their output and by a reduction of rents. This is capable of being achieved by provision of better types of seed; by more extensive use of manures, and by better cultivation methods. In this the co-operation of all the departments of Government, namely, Agricultural, Land Revenue, Irrigation, Rural Development and Co-operative, is essential. In addition to this,

[1] See *Report on the Administration of the Department of Agriculture, 1936*, p. 6.

co-operation between official and voluntary workers, cultivators and landlords, is essential to remove the fundamental difficulties and pave the path for the adoption of known improvements which would effect a revolution in agricultural production.

Agricultural Marketing

The Indian cultivator buys in the dearest market and sells in the cheapest market. He usually does not get proper value for his produce. The Co-operative Department came to his help but its activities were sporadic and limited. Recently a marketing staff has been attached to the Department of Agriculture. The Provincial Marketing Officer and the three Assistant Marketing Officers, provided through a grant from the Imperial Council of Agricultural Research, began their work from July, 1935. Marketing surveys of all fruits, tobacco, linseed, groundnuts, wheat, rice, eggs, milk, cattle and hides and skins have been completed. The survey of the fruit industry demonstrated the necessity for better methods of packing and grading. It is hoped that as a result of these surveys a more satisfactory system of marketing will emerge which will ensure a better price to the producer and introduce economies in handling, transport and distribution of products.

Conclusions

Our conclusions as to recent state policy and potentialities of agriculture may now be summarized. From the account of land revenue policy and irrigation, already given in the previous chapters,[1] it can be concluded that the Government in India has not followed a policy of *laisser-faire* with regard to land problems. The state policy in the Agricultural, Veterinary, Forest, Irrigation, Co-operative, Public Health, Medical and Industries Departments, though slow, has been constructive and successful. It is doubtful whether a more energetic policy, which would have meant increased financial pressure and increased taxation, largely to be paid by the peasantry, was desirable. Nevertheless, it cannot be denied that the state in India, in comparison with other countries, has performed some functions which elsewhere are usually performed by landlords or private enterprise.

[1] See chs. vii and viii.

Recently the Congress Government has increased the Agriculture budget from Rs. 29 lakhs in 1937–8 to Rs. 81 lakhs in 1939–40.

The potentialities of agricultural development are vast in India. 'It can undoubtedly be said that a veritable agricultural revolution could be effected by simply putting into practice the knowledge that has been gained with regard to improved varieties of crops, implements, cultural methods, and the breeding and care of domestic animals. . . . The limiting factors are finance and leadership, but surely no movement could be more worthy of both official and voluntary support.'[1] If the future finance of the Province is to be put on a healthier and more stable basis agricultural problems and policy need reorganization and change in outlook.

(iv) Industries

Need for a Better-balanced Economic System

The most desirable line of progress to increase the taxable capacity of the people is to have a better-balanced economic system. The pressure of population on the land has been considerably increased, with the result that there is under-employment in rural areas.[2] Careful estimates of cultivators' working conditions have shown that they do not have enough work for all the year round. Calvert estimated that the cultivator's work does not represent more than 150 days' full work in the year. According to Dr Slater, referring to South India, the cultivator has only work for five-twelfths of the year. Other similar estimates have been worked out. All of them show that there is an appalling amount of surplus labour in Indian villages which remains idle. And as there are few alternative methods of employment, e.g. fruit-growing, market-gardening, poultry-farming, woodwork, etc., 'the waste continues and with this poverty increases'. The best way to absorb the surplus population and to keep the people fully employed is to encourage the development of cottage industries. Incidentally, it may be mentioned here that a prominent section of Indian public opinion believes that industrial development will cure all the economic

[1] Anstey, op. cit., pp. 170 and 184.

[2] See chs. i and xiii.

ills of the country. It is this belief which has recently resulted in a greater demand for protection. Without entering into this controversy we may say that the development of agriculture is in no way antagonistic to the development of industry. In fact, both must proceed simultaneously. Each will supplement the other.[1]

The general policy of the Industries Department so far has been to assist urban industries by giving grants and loans, expert technical advice, conducting research, experiments and demonstrations, disseminating commercial and industrial information, and marketing the products of art and industries and participating in exhibitions and fairs. The department has hardly touched the problem of organization, improvement and development of village industries. The possibilities of village industries have not been explored. With the development of cheap electrical power,[2] better marketing facilities, and improved technical instruction, the possibilities for their successful development have vastly improved.

The effects of small-scale industries on India's economic life are not fully realized. These industries will fit in with the traditional environment of the people. They will absorb the natural resources roundabout and employ the surplus population which remains unemployed for a considerable part of the year. Female and child labour can also work in collaboration with male. Thus basket-making, woodwork, toy-making, bamboo- and straw-weaving, among other crafts, can be introduced successfully into the villages.

The successful working of small-scale industries even in advanced industrial countries like England, Germany and Japan proves their potentialities for India. The services of the co-operative movement and the Industries Department can be co-ordinated in their development. Small-scale industries will serve as buttresses to small farmers and will improve their economic position.

Famine Relief Fund

The Reforms, as we have seen, made the Provincial Governments liable to hold a sufficient portion of their resources against famine years.[3] The Government of India Draft Rules

[1] See ch. xiii. [2] See ch. i. [3] See ch. iii.

made it obligatory for each Provincial Government to provide in its budget annual assignments for expenditure upon relief of, and insurance against, famine. The annual assignments for each Province were:[1]

	Rs.
Madras	... 6,61,000
Bombay	... 63,60,000
Bengal	... 2,00,000
United Provinces	... 39,60,000
Punjab	... 3,81,000
Burma	... 67,000
Bihar and Orissa	... 11,62,000
Central Provinces	... 47,26,000
Assam	... 10,000

The above grants were not to be expended save upon the relief of famine or upon the construction of protective irrigation works or other works for the prevention of famine. Any portion of the grant which was not so spent was to be transferred to the Famine Relief Fund of the Province. The Provincial Government however, in any year when the accumulated total of the Famine Relief Fund of the Province was not less than six times the amount of the annual assignment, could suspend temporarily the provision of the annual assignment. The Fund was to form part of the general balances of the Central Government, which, at the end of each year, credited interest on the average of the balances held in the Fund on the last day of each quarter. The balance could also be utilized in the grant of loans to cultivators either under the Land Improvement Loan Act, 1883, or under the Agriculturists' Loan Act, 1884, or for relief purposes; or in the repayment of advances from the Provincial Loans Fund, or to meet irrecoverable balances of loans under the said Acts or for relief purposes when such loans were made from the Provincial Loan Account.[2]

[1] See Cmd. 891 (1920).

[2] See Cmd. 891 (1920) and *Appropriation Accounts and the Audit Report, 1934-5*, United Provinces, p. 38. The Famine Relief Fund was called the Famine Insurance Fund before 1928-9. The fund appears in the Provincial section of the accounts, but forms part of the general balances of the Central Government.

The United Provinces Government was originally required to contribute Rs. 39·6 lakhs annually and when the balance in the Fund reached Rs. 237·6 lakhs the assignments might be suspended. From past experience of the actual expenditure on famine relief the Government realized that the amount in the reserve would increase to a figure of which they were never likely to require more than one-fourth. The Government made a protest to the Government of India to change the rules. In this they were unsuccessful and hence they debited to the Fund interest on loans for canals which could be regarded as partly or wholly protective. The Government of India afterwards revised the rules and the annual assignment to the Fund was reduced to Rs. 16 lakhs with a maximum balance of Rs. 55 lakhs.[1]

The following is an analysis of the transactions of the Fund in the United Provinces during 1934–5:

	Rs.	Rs.
Opening balance on 1st April, 1934	55,45,271	
Add receipts		
Interest on balance of the Fund at 2½ per cent	1,38,671	
Recoveries of Famine expenditure	1,609	
		56,85,551
Deduct withdrawals—		
For expenditure on Famine Relief	29,278	
Repayment of advances from Provincial Loans Fund	1,20,000	
Other objects—Protection of Ajaigarh Town	25,479	
		1,74,757
Closing balance on 31st March, 1935		55,10,795

No assignment was made during the year as the balance in the Fund was in excess of the statutory minimum.[2]

§3. *CONCLUSIONS*

The State, through the machinery of public finance, tries to diminish inequality of incomes.[3] The expenditure on Education, Public Health, Medical Relief and other social services transfers national income from richer classes to relatively poorer classes.

[1] See *Report on the Administration of the United Provinces, 1927–28*, p. xi.

[2] See *Appropriation Accounts and Audit Report of the United Provinces, 1934–35*, p. 28.

[3] For further discussion on this point see Appendix I.

Though there are very definite limits to the powers of a State to redress inequality of incomes by deliberate changes in distribution, nevertheless, within certain limits, considerable action is possible. It is true that the expenditure on social services was smaller during the period than was popularly demanded. But it must be remembered that there were definite limitations to further expenditure.

The question may be asked, how far social expenditure has redistributed national income? Social expenditure may redistribute national income both directly and indirectly. To the extent to which tax income is directly distributed among poorer classes the effect of social expenditure is immediate and direct. The amounts distributed in England (1936) under National Health Insurance (£136 million), Unemployment Insurance (£43·7 million) and Treasury Pensions Account (£20·9 million) directly increased the income of the poorer classes.[1] In India, in the absence of these schemes there is no direct distribution of national income among the poorer classes.

The extent to which the expenditure on social services indirectly redistributes the national income from the richer to the poorer classes depends upon the type of the service and the country. 'Thus the British education service,' observes Mrs Hicks,[2] 'is more redistributive than for instance the Dutch, where all classes use the state-provided schools, both for elementary and secondary education.' It is not possible to get an accurate picture of the extent to which the poorer classes in India benefit by social expenditure. Roughly, it may be said that in primary education the benefit is entirely derived by the poorer classes; in secondary education it is shared by the poor and the rich; while in university education the benefit is exclusively confined to the middle and richer classes. In medical services, though the poor are greatly benefited, yet in important medical hospitals the rich (on account of want of development of civic responsibility) are equally, if not more, benefited. In public health the benefit is mostly confined to the poor sections of the community. But the wider influences of the service are equally shared by all members of the community.

[1] See Hicks, U. K., *The Finance of British Government*, 1938, p. 53.

[2] *op. cit.*, p. 56.

Under existing conditions it would be extremely hazardous to start National Health Insurance and Unemployment Insurance schemes in India. It must also be recognized that a sudden increase in social expenditure might add seriously to the financial difficulties of the Province.[1] The most desirable line of progress at this stage lies in gradually increasing the expenditure and organizing the services on a better basis so that the poorer classes may derive greater benefit than they do now.

The socio-economic influences of the social services profoundly affect the prosperity of a nation. The expansion of the social services, besides redistributing the national income, would form the bedrock for a healthier and nobler development of the life of a community. Hence a new orientation of public expenditure in which greater emphasis is laid on the sphere of social expenditure is the accepted policy in every country. On the whole, in the Indian Provinces, in spite of considerable individual divergence between the policies of the ministers and finance members, the influence of the above policy is clearly traceable in the provincial budgets.

The period 1937–8 marks the beginning of provincial autonomy. In the history of provincial finance no period has witnessed the introduction of so many new taxes as this period. In all the Provinces where the Congress ministries were in power, to fill the gap caused by prohibition a host of new taxes were introduced. In chapter ix we have examined the legal validity, burden and incidence of some of these taxes. To tell the financial tale of provincial autonomy would be to write the political history of the period. Unhappily financial policies have been surcharged with political controversies and the economist has to make his way through a thicket of untruths and half-truths, originating in false analogy and political bias.

This brief period of two years suddenly came to an end in November, 1939, when, as a result of the Congress attitude towards the European war, the ministers tendered their resignation. In the Provinces where the Congress party was in a majority, the Governors, in exercise of the powers conferred by section 93 of the Government of India Act, suspended the

[1] See chs. i and xiii.

constitution and declared that all functions which were performed by the ministers would be exercised by them in their discretion. The Governors have appointed Advisers and the financial and administrative machinery is being kept going with their help.

The period of the working of provincial autonomy has been too brief and it is very difficult to pass any judgement on the economic activities and financial policy of the Provincial Governments.

XI

THE PROVINCIAL BUDGETS[1]

§1. *BUDGETARY POLICY (1921–39)*

Introductory

In the financial sphere the Reforms started not in 1919 but in 1921. The budget of 1921–2 was the first budget framed under the Reforms. The economic and financial situation underwent considerable modifications between 1921 and 1939. Indeed, the period breaks up rather loosely into four sub-periods—1921–6, 1926–8, 1928–37, and 1937–9—each of which has somewhat different characteristics from the others. The leading features of the first period were increased taxation, retrenchment and loud protests against provincial contributions.[2] The partial (1925–6) and final (1926–7) remission of provincial contributions[3] and the return to fairly normal economic conditions marked the beginning of a new period in which the deficits of the earlier years disappeared. This short period of two years ended decidedly with the beginning of bad agricultural seasons (1928) which culminated in the depression of 1931. The third period was one of severe national strain in which difficulties rose to their full height. The centre of the financial alarm was transferred to land revenue. The agricultural question was debated in a highly partisan and political manner. The revenue system was loudly denounced but little attempt was made to work out a constructive programme.

The present chapter is a chronological study of the budgets and budgetary policy of the United Provinces Government. The resources and expenditure of the Government during the period 1921–39 are analyzed here.

[1] For the system of financial administration see ch. vi.
[2] See chs. iii and iv. [3] See Table VI, p. 91.

Initial Financial Difficulties

In a previous chapter we have seen that the Meston Settlement was based on the increased spending power of each Province.[1] The Committee had calculated the normal income of the United Provinces under the Reforms at Rs. 11,90 lakhs, and by deducting from this figure (i) the normal pre-Reform revenue of the Province and (ii) the expenditure which was Imperial before the Reforms but had become provincial, the Committee arrived at the figure of Rs. 3,97 lakhs, which they called the increased spending power of the Province. The Meston contribution of Rs. 2,40 lakhs (24·41 per cent of the total revenue of the Province) was based on this figure.

In calculating the expenditure of the Province the Committee did not take into consideration the upward march of expenditure which was bound to follow with the introduction of dyarchy in 1921. The rise in expenditure in the early years of the Reforms was due mainly to three causes: firstly, increased expenses on account of the inauguration of the Reforms; secondly, the general rise in prices unaccompanied by a corresponding increase in revenue; and thirdly, the expansion of the nation-building departments.

We may illustrate the effect of each of the factors, with reference to the United Provinces.

Increased expenditure incidental to the Reforms was chiefly due to:[2]

(i) the yearly instalment of the balance due to the Government of India according to the old Provincial Loan and Advance Account (Rs. 25,00,000);[3]

(ii) the liability for creating a Famine Insurance Fund (Rs. 39,60,000);[4]

(iii) the enhanced salary of His Excellency the Governor (Rs. 20,000);

(iv) the establishment of the Executive Council (Rs. 1,28,000);

(v) the appointment of ministers (Rs. 1,23,000);

(vi) the salaries of the President and the Deputy President

[1] See ch. iv.
[2] The figures refer to 1922–3.
[3] See ch. iii, p. 77.
[4] See ch. x, pp. 247–8.

and of members deputed to the Legislative Assembly and the Council of State (Rs. 59,000); and

(vii) the increased travelling allowance on account of the enlargement of the Council (Rs. 59,000).

The total expenditure due to the above causes was no less than Rs. 68,49,000.

The rise in prices which coincided with the inauguration of the Reforms resulted in a considerable and permanent increase of expenditure on the pay of officers and of establishment. The extra cost attained a figure of Rs. 3,04 lakhs.[1]

Among the important nation-building departments administered by the ministers, education, medical, public health, agriculture and industries required a considerable increase in expenditure. The aggregate expenditure on these departments rose from Rs. 1,02,52,000 in 1915–16 to Rs. 2,12,32,000 in 1922–3. The total expenditure on education in 1922–3 was Rs. 1,38,62,000 as against Rs. 60,95,000 in 1915–16. The expenditure on the medical department was 85 per cent above that of 1915–16. Expenditure in the agricultural department rose from Rs. 12,75,000 in 1915–16 to Rs. 27,75,000 (an increase of 101 per cent) in 1922–3. The most remarkable rise was in the industries department. From the modest figure of Rs. 1,12,000 in 1915–16 it increased to over 8 lakhs in 1922–3.[2]

The failure to realize these considerations was one of the principal causes of the financial difficulties of the Province.

Review of Revenue and Expenditure (1921–39)

A detailed study of the financial position of the Province during the period 1919–39 will be useful at this stage. Table XVII shows the progress of revenue and expenditure and the revenue position of the Province from 1921–2 onwards.

The table leads to two important conclusions: first, the deficit years far outnumbered years of surplus; second, both the revenue and expenditure of the Province in 1937–8 were

[1] As there were no *ad valorem* receipts with the Provinces, the rise in prices did not cause a counterbalancing increase in receipts.

[2] See *Appropriation Report of the Accounts of the United Provinces*, 1922-3, para. 21 to 29. See ch. x.

TABLE XVII

PROVINCIAL REVENUE AND EXPENDITURE[1]

(IN LAKHS OF RUPEES)

	1921–2	1922–3	1923–4	1924–5	1925–6	1926–7	1927–8	1928–9	1929–30	1930–1
Total Revenue	12,64	12,48	12,71	12,39	12,70	12,90	12,86	11,45	12,99	11,97
Total Expenditure ...	14,11	13,13	12,87	12,82	13,01	12,85	11,75	12,28	12,33	12,88
Surplus (+), Deficit (−) ...	−1,47	−65	−16	−43	−31	+5	+1,11	−83	+65(*a*)[2]	−91

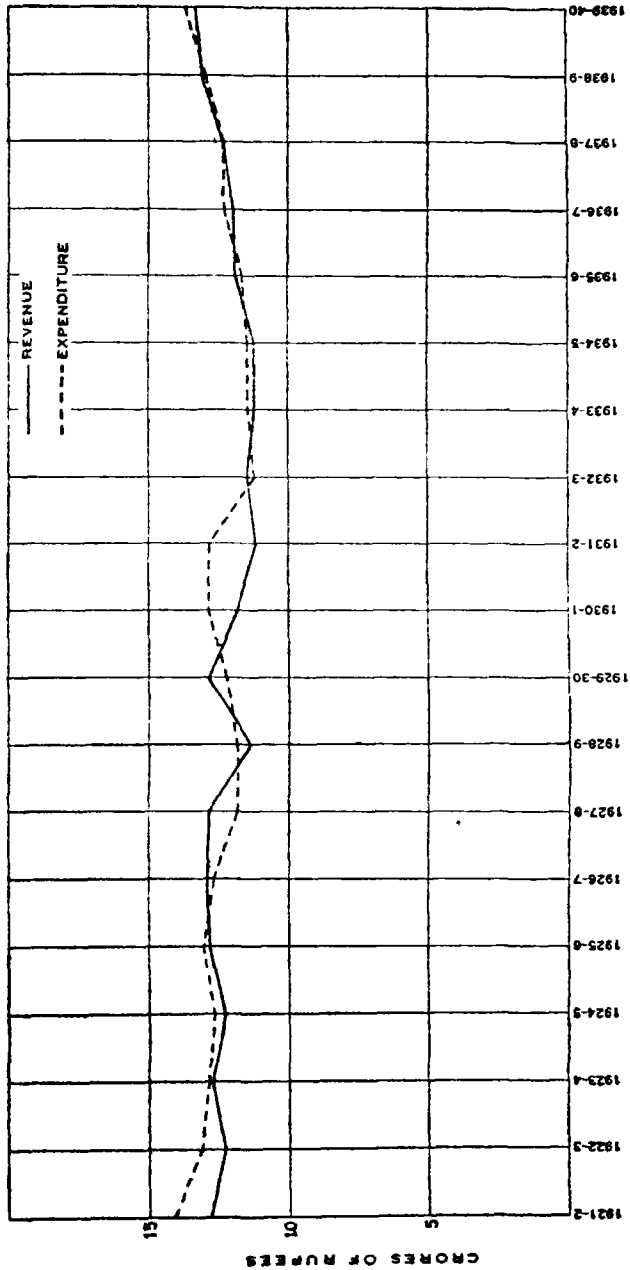
	1931–2	1932–3	1933–4	1934–5	1935–6	1936–7	1937–8	1938–9[3]	1939–40[4]
Total Revenue	11,22	11,45	11,24	11,30	11,88	11,91	12,33	13,07	13,31
Total Expenditure ...	12,84	11,30	11,27	11,43	11,71	12,29	12,33	12,92	13,69
Surplus (+), Deficit (−)...	−62(*b*)[2]	+15	−3	−13	+17	−37	—	+15	−38

[1] Compiled from the Annual *Appropriation Reports of the Accounts of the United Provinces.*

[2] (*a*) and (*b*). The transfer of the capital section of the accounts in 1929–30 of expenditure aggregating 29 lakhs on certain capital civil works debited to revenue in the years 1921–2 to 1927–8 (21 lakhs) and irrigation capital expenditure debited to revenue in 1928–9 (8 lakhs) and the adjustment of 10 lakhs representing leave salary charges of certain officers erroneously charged in previous years to the revenues of the United Provinces instead of to the revenues of other Governments in respect of leave earned by service under those Governments, augmented the revenue surplus which otherwise would have been only 27 lakhs. A similar transfer to capital of the expenditure of 11 lakhs on civil works originally debited to revenue was made in the Accounts of the year 1931–2. The revenue deficit excluding this adjustment is 23 lakhs. See *Appropriation Report of the Accounts of the United Provinces Government, 1931–32*, p. 11.

[3] Revised estimate.

[4] Budget estimate.



ROUGH GRAPHICAL REPRESENTATION OF TABLE XVII

actually less than they had been in 1921–2. A detailed study of the provincial budgets shows the highly unsatisfactory nature of the finances.

In 1919–20 the Province had an opening balance of Rs. 2,52½ lakhs. Expenditure rose during the year with the revision of the pay of superior services and the year closed with a balance of 2,21 lakhs. In 1920–1 the scales of pay of the clerical and menial establishments were revised upwards and the balance at the close of the year was reduced to 89 lakhs. The budget for 1921–2 was framed under the Reforms scheme. The revenue was estimated at 13,30 lakhs, but the fall in revenue in the case of excise, forests and land revenue disappointed the anticipations. Of this loss, excise was responsible for 62 lakhs, forests for 24½ lakhs and land revenue for 10½ lakhs. The loss in excise was partly due to the increased rate of duty which came into operation from April 1, 1921, and partly to the efforts of the Congress to discourage the consumption of liquor. The actual receipts amounted to 12,38 lakhs. The year closed with a deficit of about 1,48 lakhs; allowing for the opening balance of 89 lakhs, the deficit was 59 lakhs.[1] It is important to remember that the exceedingly disappointing financial results in the first year of the Reforms were mainly responsible for the subsequent financial difficulties of the Province.[2]

The year 1922–3 had very much the same financial features as the previous year. The receipts from all sources of revenue fell short of the budget figures by Rs. 72·59 lakhs. The main heads under which there were losses are (in lakhs of rupees) land revenue (4·40), excise (27·80), stamps (32·30), forests (31·81), registration (1·30) and irrigation (7·91). The year closed with a deficit of 65 lakhs.[3]

The two leading features of 1923–4 were increased taxation and retrenchment. Stamp duties and court fees were enhanced and a tax on motor vehicles was imposed. Irrigation rates were also increased. But on account of depression in trade, the

[1] See *Report on the Administration of the United Provinces of Agra and Oudh*, 1921–2. The small differences in the figures are due to rounding up.

[2] See *Memorandum submitted by the Government of the United Provinces to the Indian Statutory Commission*, vol. IX, p. 88.

[3] *Report on the Administration of the United Provinces*, 1922–3, p. 55.

revenue from stamps fell short of expectations by about Rs. 26 lakhs, while excise showed a decline of 19½ lakhs in comparison with the previous year.

The report of the Economy Committee, published in February 1924, made sweeping recommendations in regard to every department.[1] The Government however gave instant effect to such of the recommendations as were deemed practicable and likely to result in savings without loss of revenue or of essential efficiency. Not all the proposals of the Economy Committee met with favour even from the keenest protagonist of retrenchment.[2]

The final result was that the opening balance of Rs. 2,52½ lakhs in 1919–20 disappeared, and the total deficit since 1921 at the end of the year was nearly Rs. 1,44 lakhs.

When the year 1924–5 opened the financial prospects were favourable. The budget provided for receipts under revenue heads amounting to Rs. 12,54,69 lakhs and expenditure amounting to Rs. 12,54,69 lakhs. Including debt heads the closing balance was estimated at Rs. 1,05,58 lakhs, of which Rs. 62,26 lakhs belonged to the Famine Relief Fund and Rs. 43,32 lakhs were available for general purposes. But the disastrous floods of September 1924 upset all calculations and caused great loss of property. The result on provincial finance was serious. Revenue dropped to the lowest figure (Rs. 12,39 lakhs) since 1921. There were heavy losses under land revenue (as a result of remissions and suspensions) and irrigation (total loss was Rs. 35 lakhs), and the cost of restoring damaged canal works, roads, bridges and buildings and of assisting the District Boards to restore similar damages in their spheres of operations amounted to about Rs. 59 lakhs. In addition nearly Rs. 33 lakhs were advanced as takkavi. The total burden imposed on the Province was about Rs. 1,27 lakhs, of which about Rs. 75 lakhs fell in the year 1924–5. At the close of the year, instead of a surplus of Rs. 8·12 lakhs, there was actually a deficit of Rs. 42·96 lakhs.[3]

[1] See ch. i.

[2] See *Report on the Administration of the United Provinces*, 1923–4, pp. 31 and 32.

[3] See *Report on the Administration of the United Provinces*, 1924–5, pp. 32 and 33.

The effects of the floods (1924) were also reflected in the budget of 1925–6. The Government anticipated a deficit of about Rs. 43 lakhs. The Legislative Council declined to sanction an extension of the Stamp Amendment Act, which raised the deficit to Rs. 50 lakhs. Fortunately, when the finances of the Province were in an unsatisfactory condition, Sir Basil Blackett announced that the Government of India would reduce the contribution of the Province by 56 lakhs, i.e. from Rs. 2,40 lakhs to Rs. 1,83·83 lakhs.[1] The remission gave much-needed relief and obviated the necessity of taking a loan to finance the revenue expenditure of the Province. Even so the year closed with a deficit of Rs. 31 lakhs, as expenditure was pushed up, and the over-optimistic estimate of income from excise and irrigation did not materialize. The revenue deficit increased from Rs. 1,83 lakhs to Rs. 2,14 lakhs at the close of the year.

Two further loans of nearly two crores were raised, of which nearly $1\frac{1}{2}$ crores were expended on productive and unproductive works. The amount spent on productive works was divided between the Sarda Canal (1,02 lakhs) and the Town Improvement Trusts of Allahabad, Cawnpore, and Lucknow. The loan on unproductive works was spent chiefly on police buildings and roads. There was a closing unexpended balance of nearly Rs. 50 lakhs from loans taken from the Central Government. The Famine Relief Fund was utilized to the extent of Rs. 23 lakhs, for the construction of the Sarda Canal and other protective works.[2]

In 1926–7 a further remission of Rs. 35 lakhs in the provincial contribution considerably improved the financial position of the Province. But unexpected expenditure in the form of arrears of interest, due to a change in the dates of payment decided upon by the Central Government, and charges on account of military pensions and commutations of which no notice had been given at the time of framing the budget, caused the anticipated expenditure to be exceeded by more than Rs. 28 lakhs. Moreover, a variety of circumstances contributed to the

[1] See ch. iv.

[2] See *Report on the Administration of the United Provinces*, 1925–6, pp. 34 and 35.

financial instability of the Province. Receipts fell short by Rs. 34 lakhs and expenditure increased by Rs. 27 lakhs. For losses under receipts, land revenue and stamps were responsible to the extent of Rs. 18 lakhs. Excise revenue fell by $5\frac{1}{2}$ lakhs. The year, however, for the first time under the Reforms closed with a small revenue surplus of Rs. 5 lakhs.

Two momentous changes were introduced, with effect from April 1, 1926, in the financial system of the Province, namely (i) the separation of audit from accounts and (ii) the amalgamation of treasuries. The system of combined audit and accounts was unsuited to the reformed constitution. Hence the Government introduced a new system under which to each department or group of departments is attached an accounts section under a pay and accounts officer, with a chief accounting officer at headquarters charged with compilation and general supervision. To each accounts section an audit section, working directly under the chief audit officer, was also added. The effect of the change was that accounts were departmentalized, compilation was centralized and audit became independent.[1]

The other change was the abolition of treasuries in the smaller districts; the *sadar* treasury was reduced to the rank of a sub-treasury. The abolished sub-treasuries and the new *sadar* sub-treasury were made subordinate to the treasury of an adjoining district, which was placed in the charge of a trained accounts officer. The objects of the scheme were to improve the working of sub-treasuries, to concentrate balances in the Imperial Bank, and to reduce expenditure on treasury staff. Each amalgamation was expected to result in a saving of about Rs. 6,000 a year.[2]

In 1927–8 the complete remission by the Government of India of the provincial contribution considerably improved the financial situation of the Province. As a result of the complete remission an increased expenditure of Rs. 36 lakhs was sanctioned. The year, for the second time under the Reforms, closed with a revenue surplus of Rs. 1,11 lakhs. The financial

[1] See ch. vi.

[2] See *Report on the Administration of the United Provinces*, 1926–7, pp. 30 and 31.

position was brighter than at any time since the beginning of the Reforms.

It was expected at this stage that the financial position of the Province would steadily improve in the near future. With the abolition of the provincial contributions and the relief in 1932–3 of the annual payments of Rs. 25 lakhs towards the liquidation of debts incurred before the introduction of the Reforms scheme, and the greatly reduced annual assignment (of only Rs. 16 lakhs as against Rs. 39·60 lakhs under the old rules, with a maximum of Rs. 55 lakhs) to the Famine Relief Fund, the financial position of the Province was much easier.[1] Moreover, the Sarda Canal was expected to yield a gross income of Rs. 14 lakhs in 1929–30 and Rs. 20 lakhs in 1930–1, rising to Rs. 74 lakhs by 1940–1. The hydro-electric schemes were estimated to yield about Rs. 7 lakhs. Finally, on account of the resettlement of the Province, which was to continue unbroken till 1964, the annual growth in land revenue from the new resettlements was expected to bring in an addition of about Rs. 4 lakhs per year.[2]

These expectations were not, however, fulfilled. The year 1928–9 closed with a deficit of Rs. 83 lakhs. The main explanation for this deficit was to be found in the bad agricultural conditions of 1928 which led to substantial remissions and suspensions of land revenue.

To adjust the accounts a loan of Rs. 53 lakhs was raised on March 31, 1929; the accounts, therefore, showed a closing balance of Rs. 21·71 lakhs, of which Rs. 9·72 lakhs belonged to the Famine Relief Fund. Thus after two years of respite the Province again experienced a deficit year and the financial position was gloomy.[3]

The total revenue and expenditure in 1929–30 were Rs. 12,99 and Rs. 12,33 lakhs respectively, resulting in a surplus of Rs. 65 lakhs.[4] Agriculturally the year was more favourable

[1] See ch. x, pp. 247–8.

[2] See *Report on the Administration of the United Provinces*, 1927–8, pp. 39–42.

[3] See *Report on the Administration of the United Provinces*, 1928–9, pp. 34 and 35.

[4] See footnote to the table on p. 256.

than the previous year. The largest increases in revenue in the year as compared with the previous year were under the heads of land revenue (80·95 lakhs), irrigation (42·37 lakhs), miscellaneous (10·87 lakhs), stamps (7·95 lakhs) and interest (7·00 lakhs). The revenue from irrigation increased on account of the opening of important sections of the Sarda Canal.[1]

The next two years were years of severe economic depression. The financial position of the Province deteriorated substantially on account of the adverse agrarian situation due to continual low prices of agricultural produce. The total revenue in 1930–1 amounted to Rs. 11,97 lakhs, showing a fall of Rs. 1,02 lakhs as compared with 1929–30. All heads showed large decreases; the main ones were land revenue (37 lakhs), excise (18 lakhs), irrigation (17 lakhs), stamps, including registration (13 lakhs) and forests (12 lakhs). Expenditure, other than under debt heads, increased to Rs. 12,88 lakhs or Rs. 54½ lakhs above that of 1929–30.[2] The year closed with a deficit of Rs. 91 lakhs.

The year 1931–2 was equally bad. The total revenue in the year amounted to Rs. 11,22 lakhs, showing a fall of Rs. 75 lakhs compared with 1930–1. All heads showed decreases; the main ones were land revenue (36 lakhs), excise (4 lakhs), irrigation (12 lakhs), stamps and registration (4 lakhs), forests (4 lakhs), interest (2 lakhs), administration of justice and jails (3 lakhs) and agriculture (1 lakh).

On account of the heavy fall in revenue, expenditure was curtailed considerably, with the result that expenditure fell to nearly Rs. 11,82 lakhs, i.e. Rs. 1,05 lakhs below the corresponding total of 1930–1. The year closed with a deficit.

The total revenue in 1932–3, amounting to Rs. 11,45, showed an increase of Rs. 23 lakhs as compared with 1931–2. Land revenue showed a further decrease of Rs. 42 lakhs, but the revenue from excise (14 lakhs), stamps (19 lakhs) and irrigation (32 lakhs) increased. Expenditure was decreased by Rs. 54 lakhs as compared with the previous year and the year closed with a surplus balance of Rs. 15 lakhs.[3]

[1] *Report on the Administration of the United Provinces*, 1929–30, pp. 89–94.
[2] *Report on the Administration of the United Provinces*, 1930–1, pp. 51–6.
[3] *Report on the Administration of the United Provinces*, 1932–3, pp. 63–4.

The total revenue in 1933–4, amounting to Rs. 11,24 lakhs, showed a decrease of Rs. 21 lakhs as compared with that of 1932–3. The revenue under land revenue, stamps and irrigation fell by Rs. 13, 10 and 8 lakhs respectively. The economies in expenditure effected during the last three years to meet the fall in revenue due to poor crops and the slump in prices were continued, and the expenditure was reduced by Rs. 3 lakhs. The total expenditure was Rs. 11,27 lakhs. The year closed with a small deficit balance of Rs. 3 lakhs.[1]

The year 1934–5 was also a deficit year. Though the total revenue increased by about Rs. 6 lakhs as compared with that of 1933–4, yet on account of increased expenditure (Rs. 1,60 lakhs) the year closed with a deficit balance of Rs. 13 lakhs. While the revenue from land revenue (Rs. 28 lakhs) and forests (Rs. 4 lakhs) increased, stamps and irrigation showed a decrease of Rs. 14 and Rs. 11 lakhs respectively. The finances of the Province did not show any sign of improvement.[2]

The year 1935–6 closed with a surplus of Rs. 17 lakhs. The total revenue increased by Rs. 58 lakhs, as compared with the previous year, to Rs. 11,88 lakhs. The important heads which showed increase were land revenue (2 lakhs), excise (7 lakhs) and irrigation (46 lakhs). The total expenditure was Rs. 11,71 lakhs.

During 1936–7 there was a deficit of Rs. 37 lakhs. Land revenue again fell from Rs. 5·88 to Rs. 5·66 lakhs, as compared with the previous year. The revenue from excise and stamps increased by Rs. 13 and Rs. 12 lakhs respectively. The revenue from forests dropped by Rs. 3 lakhs. The expenditure increased by Rs. 58 lakhs.[3]

The year 1937–8 closed with a small deficit of Rs. 27,000. The total revenue and expenditure were Rs. 12,33,03 and Rs. 12,33,30 (000 omitted) respectively. There was a fall in receipts under land revenue and stamps. The decrease under land revenue was chiefly due to increased remissions, and the liberalization of remission rules. The revenue from stamps again fell by Rs. 14·5 lakhs.

[1] *Report on the Administration of the United Provinces*, 1933–4, pp. 57–60.
[2] *Report on the Administration of the United Provinces*, 1934–5, pp. 83–6.
[3] *Report on the Administration of the United Provinces*, 1935–6, p. 69.

The deficit caused by the fall in revenue was mainly covered by the additional receipts from three main sources. The first was an increase of about Rs. 3 lakhs in income-tax receipts from the Central Government as the share of the Province. Secondly, there was an increase of Rs. 17·6 lakhs in the receipts from irrigation due to an increased demand of water on account of a dry season. Lastly, the sugar-cane cess yielded about Rs. 3 lakhs. A tax on entertainments was also introduced during the year.

The Government floated a loan of a crore of rupees at 3 per cent, with an issue price of Rs. 99 for every Rs. 100. The loan was taken mainly for the construction of irrigation and hydro-electric works and to finance the road development programme.

The total revenue and expenditure during 1938–9 were Rs. 13,07 and Rs. 12,92 lakhs respectively (revised estimates). In 1939–40 the Budget estimates for revenue and expenditure were Rs. 13,31 and Rs. 13,69 lakhs respectively. To cover the deficit two important taxes were introduced. A tax on petrol at the rate of 2 annas per gallon was imposed. The tax was expected to bring a revenue of Rs. 8 lakhs. The Government also introduced an employment tax on persons getting a salary of Rs. 2,500 or more per annum. In chapter ix we have already examined the legal validity and the burden and incidence of the tax.

§2. *STAGNATION OF REVENUE*

Progress of Revenue under Principal Heads

An outstanding feature of this summary of the provincial budgets is that the finances of the Province are unsatisfactory. The reason for the unsatisfactory nature of the finances is due to the stagnation of revenue. This will be apparent from a consideration of the chief items of provincial revenue set out in Table XVIII.

Each of these heads of revenue has been discussed in detail in previous chapters. We shall confine our attention here to their broad tendencies. Land revenue in 1936–7 was Rs. 1,15 lakhs less than in 1921–2. The main reason for this decrease is the unprecedented fall in the prices of agricultural products

TABLE XVIII

PROGRESS OF REVENUE UNDER PRINCIPAL HEADS

(IN LAKHS OF RUPEES)

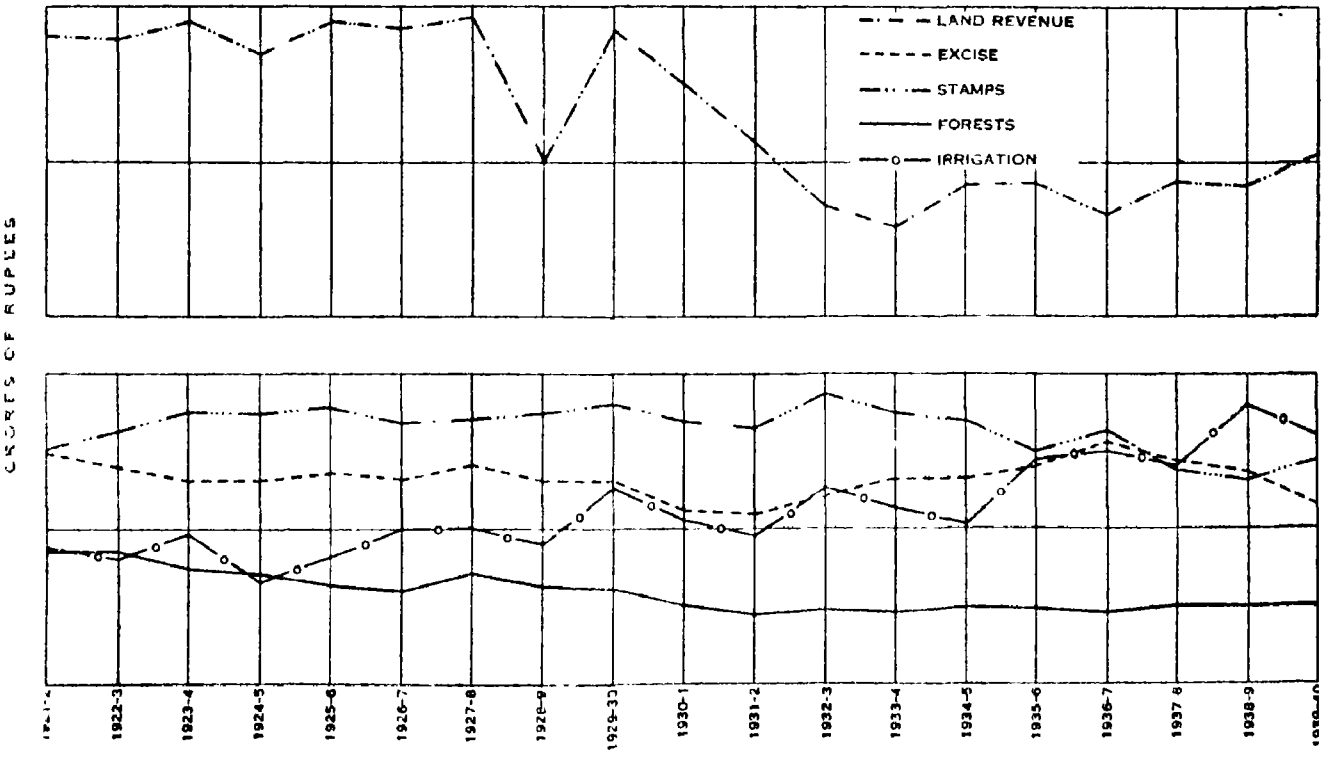
HEADS	1921–2	1922–3	1923–4	1924–5	1925–6	1926–7	1927–8	1928–9	1929–30	1930–1
Land Revenue[1] ..	6,81	6,80	6,92	6,71	6,90	6,88	6,93	6,04	6,85	6,48
Excise	1,49	1,41	1,31	1,31	1,33	1,31	1,41	1,31	1,30	1,12
Stamps	1,51	1,61	1,75	1,74	1,77	1,69	1,71	1,73	1,81	1,70
Forests	86	84	74	69	64	59	72	62	62	50
Irrigation	87	82	96	65	83	1,00	1,01	90	1,25	1,08
HEADS	1931–2	1932–3	1933–4	1934–5	1935–6	1936–7	1937–8	1938–9[3]	1939–40[4]	...
Land Revenue ...	6,12	5,71	5,58	5,86	5,88	5,66	5,87	5,85	6,05	...
Excise	1,08	1,22	1,31	1,34	1,41	1,54	1,45	1,36	1,15	...
Stamps	1,66	1,86	1,75	1,60	1,50	1,62	1,38	1,32	1,44	...
Forests[2]	45	46	45	49	49	46	50	50	50	...
Irrigation	98	1,28	1,16	1,06	1,47	1,51	1,41	1,81	1,62	...

[1] The drop in land revenue is due to the remission granted by the Government.

[2] The fall in forests revenue is principally due to the fall in the prices of timber and other forest products. As a measure of retrenchment additional capital expenditure on forests was also not sanctioned. See *Annual Report on Forest Administration* (*1938*), p. 21.

[3] Revised estimate.

[4] Budget estimate.



ROUGH GRAPHICAL REPRESENTATION OF TABLE XVIII

during recent years, from which the Province has not yet recovered. But even during the early years of the Reforms land revenue did not show any considerable expansion. In addition to the fall in prices (which resulted in an annual remission of Rs. 1,13·06 lakhs), the lengthening of the period of resettlement, the limitation of the percentage increase that may be made at any one resettlement, and the restriction of the percentage of the net assets of the land that may be taken by land revenue, were also responsible for its very slow growth. Today, under steady pressure of the peasant interests, there is no possibility of its increase in the future.[1]

As regards liquor excise, the yield declined considerably for a number of years, and in 1938–9 was Rs. 13 lakhs less than it was at the beginning of the Reforms. With the strong prohibition movement the excise revenue is bound to decrease considerably in future.[2]

With the raising of court fees and stamp duties, the revenue from stamps showed a small increase up to 1932–3. Lately (from 1933–4), however, it has shown diminished receipts. With the growth of business the revenue from stamps should steadily increase. This is almost the only present provincial source of revenue of which it can be said with some assurance that there is a margin of probable increase.[3]

The income from forests decreased during the period from Rs. 86 lakhs to Rs. 46 lakhs (i.e. about Rs. 40 lakhs). The short-sighted and faulty policy of the Provincial Government and the fall in the price of timber and forest products led to this heavy fall. The income from forests will not increase unless considerable capital expenditure is spent on forest development.[4]

The only source of income which has shown considerable expansion of revenue is irrigation. With the construction of new irrigation schemes, particularly the Sarda Canal, the income from irrigation increased from Rs. 87 lakhs in 1921–2 to Rs. 1,81 lakhs in 1938–9. Still, the irrigation position is

[1] See ch. vii. [2] See ch. viii.

[3] See *Report of the Indian Statutory Commission*, vol. II, Cmd. 3569, p. 227. See chs. i and ix.

[4] See ch. viii. In 1937–8 the forest revenue was Rs. 56 lakhs.

unsatisfactory and the irrigation rates need revision.[1] The income from irrigation should increase in the near future.

Some general conclusions as to the provincial revenues may be stated briefly here. Firstly, the taxes assigned to the Province have ceased to be prolific. Secondly, the Province has not attempted to acquire a share of the increment in the value of land in the form of income-tax, death duties or larger irrigation dues. Thirdly, the Province through its short-sighted and faulty forest policy has not developed forest resources. Provincial revenues cannot be put on a sounder basis unless some of the suggestions indicated in chapter xiii are adopted.

Conclusions

From the review of the budgets the one irresistible conclusion that can be drawn is that the financial policy pursued by the Government has been extremely timid. Too much reliance during the period was placed on retrenchment. No attempt was made to transfer a greater burden to the landholding classes or to encourage capital expenditure (e.g. on forests). The expenditure on nation-building departments could not increase as the resources of the Government were extremely limited.

Unfortunately, just when the Province seemed to be entering a period of prosperity, the depression of 1929 frustrated these hopes. The measures adopted by the Government to relieve distress among the peasantry proved inadequate and caused widespread dissatisfaction among the masses. In the absence of sufficient data it is difficult to make a general statement as to the actual amount of suffering among different agricultural classes and areas, as conditions vary greatly. Nevertheless, we agree with Dr Anstey that practically all agriculturists have suffered, but the extent of suffering has been greatly affected by the degree of self-sufficiency and the extent of dependence upon particular crops. The more commercialized agricultural areas and classes have suffered more than those which are relatively self-sufficing.[2]

The agriculturist was able to tide over the agricultural crisis partly by his considerable powers of resistance and partly by

[1] See ch. viii. [2] ANSTEY, op. cit., p. 488 (xxvi).

'living on capital'. The large export of 'distress gold' and the failure in many cases to pay rent, land revenue, or interest of debt, show that the ryot utilized capital resources to supplement his income and maintain his standard of life.[1] These resources, however, in most cases have been exhausted. Moreover, the depression has left a legacy of increased burden of indebtedness. Hence there is strong reason to fear that in a future depression the entire land revenue system will collapse unless the land revenue is reorganized along the lines suggested in chapter vii, that is, by lowering the percentage of the rents of revenue demand and levying an income-tax on agricultural incomes. In addition to a revision of the revenue policy earnest efforts should be made to improve the productivity of land and to supplement the income of the agriculturists by developing cottage industries in rural areas. The hope for the future lies in improving the general economic condition of the country.[2]

[1] ANSTEY, op. cit., p. 488 (xxvii).

[2] See chs. v and xiii.

XII

LOCAL TAXATION

§1. *INTRODUCTORY*

In the studies on provincial finance in India inadequate attention has been paid to the problems of financial relationship between the Provincial Governments and local authorities. The administrative and financial problems of Provincial Governments and local authorities, though closely knit together, are treated in isolation. The financial policy of the Provincial Government has no relation to that of local authorities. The tax policy of each local authority is also separate and has no relation to that of the rest.[1]

The disadvantages of such an uncontrolled and unco-ordinated tax system are obvious. It has created inequalities of tax burdens between individuals and between one district and another. The widely different tax rates imposed by municipalities and district boards on goods and merchandise entering their limits (e.g. in the shape of octroi) has made it impossible to know the exact burden which trade and industry has to bear or the relative burden on different commodities. This unco-ordinated system has also resulted in a lack of efficiency and economy in the administration of local services. Lastly, it has not led to a healthy development of local self-government, towards what Sidney Webb calls that national minimum of efficiency in local services, which is now regarded as indispensable in the interests of the nation as a whole.

The object of this chapter is to consider briefly the present situation and the lines along which the financial relations between the Provincial Governments and local authorities may be co-ordinated so that a greater element of efficiency, economy and harmony may be introduced into the tax system of the country. With this end in view the financial problems of local authorities may be studied in two parts:

[1] See ch. i.

(i) the problem of areas and functions and the resulting inequality in tax burdens; and

(ii) the principles and methods to be followed by the Provincial Governments in rendering help to local authorities.

§2. *THE PROBLEM OF AREAS AND FUNCTIONS*

Causes of Decay of Village Communities

To achieve efficiency in local tax administration and to distribute equitably the tax burden a scientific delineation of local areas is necessary. The size and area of the local authorities has been determined in India, as in most other countries, by political and historical factors. In pre-British days the village was an autonomous body; its local self-government functions were in the hands of village communities. This autonomous character of the village life gradually disappeared under British rule owing to the establishment of local civil and criminal courts, the present revenue and police organization, the increase of communications and the growth of individualism.[1]

This process of transformation was completed when the East India Company, to facilitate the collection of land revenue, divided the country into new regional units (districts) and placed them under the charge of Collectors. These radical changes touched the root of local self-government in India. This changed atmosphere, surcharged with individualism, led to the final disappearance of those village communities which had formed the basic unit of local self-government in the country. The village *panchayat*, the executive body of the village communities, sanctioned by both ancient law and custom, became an impotent body on account of the rising tide of individualism and the increasing importance of civil and criminal courts.

At the present time, beginning with the Presidency Corporations of Bombay, Calcutta and Madras, we have several layers of Governmental units consisting of municipalities, district boards, taluk boards, notified areas and cantonments, down to

[1] *Report of the Royal Commission on Decentralization*, Cmd. 4360 (1908), par. 696.

the *panchayats*. The exact number of these units varies in different Provinces and also within different districts of the same Province. But generally for rural areas the district board is the unit of local self-government.

The Area Served by the District Boards is Too Large

The area served by the district boards is unquestionably too big. Whereas in England there is one local body to every four square miles and in France to every six square miles, in India there is a local board to 1,494 square miles.[1] The unwieldy size of the areas under district boards has very important consequences in the raising of taxes and in the efficiency of administration of local services.

Firstly, size has an important bearing, as the Taxation Enquiry Committee observed, on the question of taxation, since unquestionably the facility for raising contributions for local purposes increases as the size of the unit of taxation decreases.[2] With an inadequate and corrupt staff, the chances for fraud, tax evasion and embezzlement become extraordinarily high in India. Moreover, the lack of proper facilities in raising taxes due to too large areas results in maldistribution of tax burdens between the different classes of rural population. The large landholders and village traders, who also perform the work of indigenous bankers, do not contribute their fair share.

Secondly, the district boards are not able to pay adequate attention to all the different parts of their large areas. The Council of a small English borough, observes Professor Cannan, finds difficulty enough in reconciling or disregarding the demands of different parts of its areas for road repairs, lighting, parks, and such like things.[3] A district board in India, covering an area of more than 1,400 square miles, necessarily finds it extremely difficult to reconcile the claims and counter-claims of the thousands of villages under it.

Thirdly, the present areas of the district boards are

[1] See *Report of the Indian Taxation Enquiry Committee* (1924–5), p. 289.

[2] ibid., p. 290. The Committee observed: 'In rural areas the jurisdictions of the local bodies are too large from the fiscal point of view' (p. 322).

[3] CANNAN, *The History of Local Rates in England* (P. S. King), 2nd edition, pp. 174–5.

unsuitable for the efficient and economic performance of the services undertaken by them.

Optimum Size of Local Bodies

An inquiry into the character of the services performed by such local authorities leads us to consider the optimum size of such bodies in order that the unnecessary waste in both the raising of revenue and the provision of a given quantity and quality of service may be reduced to a minimum. In the absence of such a knowledge the best efforts of the most capable administrators may not produce desirable and satisfactory results. For, 'if the governmental organization is defective', says Professor Lutz, 'it becomes impossible to measure the relation between efforts and results, and immense sums may continue to be poured into certain administrative channels, only to disappear without a trace, like the river that flows into desert sands'.[1]

Theoretically, to improve the relation between resources and functions in the case of local authorities two courses of action are open :

(i) jurisdictional changes ; and

(ii) re-allocation of functions between units which can perform them in the most efficient way.

A Plea for the Revival of Village Panchayats

Jurisdictional maladjustments cannot be easily corrected. The best way to correct such maladjustments, with least disturbance to the existing administration, would be to revive the village *panchayats*. The Indian village *panchayats* have been from times immemorial the basic unit of administration. Their revival would increase efficiency, economy and good administration in local areas and would facilitate the reform of maladjusted tax-burdens and the introduction of a rational policy for the determination of aggregate public expenditure, great or small, in directions which would avoid waste and increase efficiency.

The Royal Commission upon Decentralization in India (1908), clearly visualized the importance of local governmental units, and in order to arrive at a better level of administration

[1] LUTZ, *Public Finance*, p. 110.

in the field of local self-government, strongly recommended the desirability of starting such bodies, in the following terms:

> We are of opinion that the foundation of any stable edifice which shall associate the people with administration must be the village, as being an area of greater antiquity than administrative creations, such as *tahsils*, and one in which the people are known to one another, and have interests which converge on definite and well-recognized objects like water supply and drainage. It is probable, indeed, that the scant success of the efforts hitherto made to introduce a system of rural self-government is largely due to the fact that we have not built up from the bottom.[1]

Re-allocation of Functions between District Boards and Village Panchayats

The revival of village *panchayats* should be followed by a policy of re-allocation of functions between district boards and such units. The present area of the district boards being too large, the transfer of the administration of services like those of education, village sanitation and drainage, registration of vital statistics, vaccination, prevention of diseases of animals and destruction of insects and pests, to village *panchayats*, would undoubtedly increase efficiency and economy in their administration.[2] On the other hand, the provision of hospitals, building of highways, paths and bridges, improvement of agriculture, development of rural industries, and what is broadly conveyed by the term 'rural reconstruction' should be left to district boards.

It should not, however, be forgotten that this policy of decentralization of functional readjustments accompanied by financial grants must be accompanied by centralized control to achieve good results. The district boards, in the interests of a well-regulated, co-ordinated and uniform policy, must be given powers of control and supervision over the *panchayats*. Similarly, for similar reasons, the services performed by the district boards must be properly supervised by the Provincial Governments.

[1] Cmd. 4360 (1908), par. 699.

[2] In cases where a village would be too small a unit to control these services, it may be suggested that neighbouring villages (where distances permit) should share such services, e.g. a village school. See ch. x.

This policy of functional re-allocation, accompanied by centralized control, raises a number of important problems. We shall, however, consider only two aspects of these problems: namely, as the finances of local authorities are low all over the country methods are suggested to increase their resources: secondly, to supplement their inadequate resources the way in which the Provincial Governments should help and supervise local authorities is indicated.

§3. *MAIN SOURCES OF INCOME OF LOCAL AUTHORITIES*

Income of Municipalities

The sources of income of local authorities may be grouped under four heads:

(1) Taxes on trade.
(2) Taxes on property.
(3) Taxes on persons.
(4) Fees and licenses.

The following table shows the income of the municipalities in the United Provinces for 1934–5 and 1935–6.

TABLE A[1]

HEADS	1934–5 Rs.	1935–6 Rs.
Government grants	6,46,747	6,02,613
Octroi	37,96,277	38,66,249
Terminal tax...	28,48,837	28,57,064
Water tax	18,27,999	18,74,004
Tax on houses and lands	11,25,929	11,58,337
Terminal toll	7,36,481	7,61,463
Tolls (on roads and ferries)	5,43,648	5,75,273
Tax on animals and vehicles	3,55,979	3,19,150
Pilgrim tax	2,28,221	2,42,721
Tax on professions and trades	1,70,114	1,75,158
Tax on circumstances and property ...	1,29,764	1,18,625
Conservancy tax	1,32,501	1,25,269
Miscellaneous	2,81,306	3,22,960
Income from other sources than taxation .	55,41,477	54,56,140
Total income ...	1,74,44,673	1,75,36,235

[1] See *Report on the Working of the Municipalities in the United Provinces*, 1935–6.

Income of District Boards

The income of the district boards under each of the more important heads is shown in the following table:

TABLE B[1]

HEADS	1934–5 Rs.	1935–6 Rs.
Government grants	81,34,020	81,98,993
Local rates	74,61,395	74,37,115
Circumstances and property tax	6,62,199	5,49,240
Land Revenue (Kumaun Division only) ...	45,758	45,110
Pounds	6,78,125	6,71,552
Ferries	6,62,723	6,51,870
Education	11,83,548	9,11,066
Medical	3,88,220	3,77,339
Public Health	18,559	22,722
Veterinary	25,113	34,649
Fairs and Exhibitions	1,43,071	1,47,495
Interest	58,004	38,832
Unspent Government grants	87,973	63,067
Total income	1,97,41,551	1,93,97,009

(*1*) *Taxes on Trade*

Octroi—Its Defects. It will appear from Table A that municipalities place too much reliance on indirect taxes. Octroi, terminal taxes and tolls form their most important sources of revenue. All these are ancient and primitive taxes and have their historical basis in the benefit of the market in which the producer and trader required safety to carry on their market operations in isolation. This was justified in unsettled times but is now hardly a legitimate basis for their imposition.

These duties are levied on goods and merchandise entering municipal limits.[2] In the form in which they are levied in India they offend against all the canons of taxation. They are

[1] *See Report on the Working of the District Boards in the United Provinces*, 1935–6.

[2] In the United Provinces, octroi, terminal taxes or tolls are imposed on grain, refined sugar, *ghi*, unrefined sugar, animals for slaughter, oil and oil-seeds, drugs, gums, spices, perfumes, cloth and piece-goods, articles of clothing, etc., etc.

uncertain in their incidence.[1] They not only hamper the trade and industry of the country but fall with inequitable weight on poorer classes whose necessaries of life form the main items of such tax receipts. The burden of octroi per head of population in some of the municipalities in the United Provinces during the year ending March 31, 1936, is shown in the following table:[2]

Municipality	Incidence of Taxation (net collection) per head of Population
	Rs. a. p.
Koil (Aligarh)	2 7 4
Etah	2 4 10
Bareilly	2 13 0
Pilibhit	2 5 2
Gorakhpur	2 5 9
Allahabad	2 7 7
Cawnpore	0 1 11
Farrukhabad	0 0 7
Lucknow	0 2 6

The collection at municipal limits and the system of refunds causes a great amount of inconvenience to the taxpayer and results in laxity of supervision and consequent evasion of the tax. An extreme example may be cited. At Rae Bareli the sum refunded on account of tobacco exceeded the net amount realized from the tax.[3]

Sir Josiah Stamp summed up the defects of octroi as follows:

> In my judgement, both theoretically and on the result of experience, no country can be progressive that relies to any extent upon octroi, which has nearly every vice.[4]

The popularity of these taxes, in spite of these grave defects, is due to the fact that as their incidence is shifted it becomes very difficult to determine who ultimately bears the burden of the tax. The tax is ' wrapped up in the price of the commodity'.

[1] *Taxation Enquiry Committee Report*, p. 291.

[2] See *Report on the Working of the Municipalities in the United Provinces*, 1935-6. [3] ibid.

[4] Quoted in the *Taxation Enquiry Committee Report*, p. 291.

The collection of octroi through the railway agency has removed some of the administrative difficulties, and the municipalities have in this way also transferred the odium of collection to the railway company.

Apart from these features it is to be regretted that the Government of India and the Provincial Governments have not so far exercised an effective control over the trade of the country. Customs barriers, which are serious obstacles to international trade, cannot always be easily avoided, on account of political, national or vested interests. Octroi and other internal transit duties are merely customs in disguise. It is unfortunate that in the Devolution Rules local authorities were allowed to impose taxes without effective control by a central body. To protect inter-provincial and inter-regional traffic from obstruction it is essential that the Government of India should pass a law defining the powers of local authorities to tax the trade of the country. Meanwhile, the local Governments should see that:

(i) Octroi is low and as nearly uniform as possible.[1]
(ii) It does not bear unfairly on through trade.
(iii) The cost of collection is reduced.
(iv) Its administration is improved.[2]

(2) *Taxes on Property*

(*a*) *Municipalities.* Among the most important taxes on property levied by municipalities are taxes on houses or houses and their sites. Cesses on land, generally with reference to their use for agricultural purposes, are imposed by the local Government for district boards. The practice as regards the basis and rates of assessment of the house tax varies in the different Provinces. Annual value, however, is the most popular basis of assessment. The rate of the tax varies with different municipalities, the average being between 7½ to 12½ per cent. In some Provinces (e.g. in the United Provinces) the tax is collected from the owners of the houses, while in others it may be collected either from the owner or the occupier.

[1] The local Government should appoint committees to revise the widely divergent tariff schedules of the municipalities.

[2] See ch. iii.

It is to be regretted that while the tendency in local finance of most countries is towards the replacement of indirect by direct taxes, in India direct taxation of property has not made considerable progress in municipal finance. The octroi, with all its unpalatable features as we have seen, still dominates the field of local finance. In taxation of houses the two cardinal principles of benefit and ability are harmoniously combined. Taxation of houses covers the payment for definite services, such as street-lighting, drainage, communication, etc., which 'benefit' property. House property also affords a rough but tangible measure of the owner's (or occupier's) capacity to pay.

The two main reasons for the low yield of taxes on houses are the reluctance of municipal commissioners, dependent on the suffrage of the rate-payers, to increase or introduce the house-tax. The defective machinery of collection and favouritism in assessment form the most outstanding features of local finance in India. In the reviews of the working of municipalities the Provincial Governments comment severely on the heavy arrears of revenue. The Annual Report of the Examiner of Local Funds, Punjab, pointed out that accumulated arrears were enormous. Remissions were freely granted and sums written off without adequate investigation particularly when they were due from influential persons.[1] The Report on the Review of Municipal Taxation and Expenditure, Bombay, pointed out that the growth of arrears was a disquieting feature of municipal finance. With some notable exceptions, there was hardly a municipal board which was fully alive to its responsibilities in the matter.[2] In Bengal, the Commissioner of Rajshahi Division remarked that heavy outstanding liabilities leading to financial difficulties of the municipalities could be attributed chiefly to inefficiency in collections and to the reluctance of the municipal executives to have recourse to coercive measures.[3] In Madras, the Examiner of Local Fund Accounts drew attention to cases of non-levy of taxes, short assessments, omissions in assessments,

[1] *Report on the Working of Municipalities in the Punjab*, 1935–6, p. 1.

[2] *Report on the Review of Municipal Taxation and Expenditure, Bombay*, 1936–7.

[3] *Resolution Reviewing the Report on the Working of Municipalities in Bengal*, 1935–6.

generous remissions and writings-off and delays in collection work.[1] In the United Provinces the percentage of collections to demand was 78·37 per cent.[2]

The conclusions with regard to the unhealthy features of municipal administration may be expressed in the words of the Bengal Government: 'Municipal finance will continue to present a problem of perplexing difficulty so long as the municipal bodies display a reluctance to tap adequately the resources at their disposal. Unwillingness to face the unpleasant duty of fresh and enhanced taxation, laxity in the recovery of taxes, current as well as arrears, and disregard of financial canons' retard the path of municipal progress.[3]

(*b*) *District Boards.* In rural areas cesses (local rates) on land revenue or rent form a considerable burden on tenants in many Provinces where the land is held by landlords. Most of the local cesses, which were largely illegal exactions, were abolished by the Permanent Settlement and the early revenue regulations. A consolidated low cess, however, was continued and was chiefly utilized for local purposes. Between 1871 and 1905 considerable additions were made to these cesses and they were utilized for the building-up of the Famine Fund and the payment of village officials. Sir Edward Barker's reforms of 1904–5 and 1905–6 abolished all cesses except those levied for local purposes.

The basis of the assessment of the cess varies with the systems of land revenue. In the ryotwari areas of Madras, Bombay, and Burma and the temporarily settled areas of Assam, the Central Provinces and Berar, land revenue is taken as the basis of assessment. In the temporarily settled areas of the United Provinces and the Punjab the basis is the annual value of land (which is defined as twice the land revenue). In the permanently settled areas of Madras the rent actually payable to the landlord of the intermediate tenure-holder is the basis of assessment. In Bengal, Bihar and Orissa ' the cess is based on the rental value as estimated by the Collector less a deduction

[1] *Report of the Local Self-Government Department in Madras*, 1936.

[2] *Report on the Working of the Municipalities in the United Provinces*, 1935–6.

[3] *Resolution Reviewing the Report on the Working of Municipalities in Bengal*, 1935–6, p. 12.

to be calculated at one-half of the rate for every rupee of the revenue paid'.[1] In the permanently settled areas of the United Provinces there is an acreage cess which is fixed at 2 as. 6 ps. per acre of areas under cultivation. There is also a road cess (applicable to permanently settled areas) assessed at one per cent of the land revenue.

The maximum rates of the cesses are fixed by the Provincial Government, and the local bodies are given the discretion to fix their rates within the maxima. In the United Provinces the maximum rate is 6¼ per cent. The yield from local rates during 1935–6 in the Province was Rs. 74,37,115.

As regards the persons who pay the cess the practice varies from Province to Province. In ryotwari areas it is levied upon the landholder, who may or may not shift it when sub-letting the land. In the United Provinces the local rate is payable by the landlords but every tenant is liable on his land for such a number of pies per rupee of the rent or revenue of the land held by him as the local Government may determine. In the Punjab the local rate is payable by the landlord, but in cases where the land is held by an occupancy tenant at a favourable rate the landlord may realize a share of the rate from the tenant. In the permanently settled areas of Madras the cess is payable by the landlord who, however, is entitled to receive half of it from his tenants. In Bengal the landlord pays, but is entitled to recover from his tenants the entire amount, less an amount calculated at half the rate for every rupee of revenue paid by him. The cultivating tenant is liable to pay to the person to whom his rent is payable one-half of the cess.[2]

The local rate forms the most important source of revenue of rural bodies in India. In the United Provinces it contributed 38 per cent to the total revenue of the district boards. The tax is economical to the board as it is collected along with land revenue. Its assessment, however, in the permanently settled areas, where it involves a special process, adds to the cost of general administration. Where it is levied at a flat rate it is not proportional to the ability of the rate-payer. In areas where it is based on acreage it is not proportional to the taxable capacity

[1] *Report of the Taxation Enquiry Committee*, p. 311.
[2] ibid., p. 315.

of the lands. Nevertheless, the tax, as it is used for purposes of local improvement, benefits the property of the taxpayer. The tax is based on the benefit theory of taxation.

The reduction in the percentage of rents and revenue suggested in chapter vii demands an increase in the comparatively low rates, which are in some cases less than 2 per cent of the annual value of land. It is suggested that the local rate should be raised to 12½ per cent of the annual value in places where it is below that figure.

(3) Taxes on Persons

Among the important taxes on persons a tax on circumstances and property, and a tax on professions, trades and callings may be mentioned. A tax on circumstances and property may either be an alternative or a concomitant to a house-tax. In small and decaying towns house-tax is often a fallacious index of the circircumstances of the owners or occupiers. Hence a tax on circumstances and property, in place of a house-tax, is levied. In some cases a tax on circumstances and property is a useful supplement to a low house-tax.

It is levied in some of the small municipalities of the United Provinces and its yield during 1936–7 was only Rs. 1,29,704. Like all other direct taxes it is disliked by the people, and the income from it is falling. In places where it is levied, due to corrupt administrative machinery, the influential and rich escape and the burden falls on the poor.

In the United Provinces in rural areas there is also a tax on circumstances and property which is levied on income other than agricultural. In view of the reduction in the percentage of land revenue,[1] the tax on circumstances and property presents the first attempt to tax rural incomes. The tax schedules should be revised and the tax should be levied on a progressive scale, incomes below a certain limit, say Rs. 250, being exempt. The present condition that incomes from agriculture are exempt should also be removed. It should not be inferred from the above suggestion that this would be creating too heavy a burden on landlords; firstly, because we have

[1] Ch. vii.

suggested a reduction in the percentage of land revenue from 40 to 25 per cent; secondly, as the proceeds of the tax would be devoted to the development of the areas from which the tax is realized, it would benefit the property of the owners and increase rural amenities of life. With an efficient tax machinery the tax on circumstances and property would increase the resources of rural local bodies and lead to a healthy development of rural activities.

A tax on professions and trades is levied by both municipalities and district boards. In municipal areas it is levied in Madras, Bengal and the United Provinces. In Madras and the Punjab it is levied in rural areas. In places where there is no tax on circumstances and property a tax on professions and trades can be made an important source of revenue. The tax would yield a considerable amount of revenue in industrial and trading centres. In rural areas it would tap the incomes of village *mahajans* and traders.

(*4*) *Fees and Licenses*

Fees and licenses are numerous and are levied for a variety of purposes. Fees for specific services (e.g. scavenging), license fees on carriages and animals, and license fees for the regulation of offensive and dangerous trades are levied by almost every municipality in India.

It may be suggested that license fees for tea and betel shops may be introduced by municipalities. As such shops are very common the yield from the fees would be considerable. The realization of the fees would be an easy matter. It can be made an important source of revenue.

Conclusions

The conclusions of the previous pages may be summed up briefly here.

(i) An attempt should be made to do away with octroi and terminal taxes. Meanwhile, administrative defects and the basis of assessment should be improved.

(ii) Greater reliance should be placed on direct taxation. In municipalities taxation of property should be made the most important source of revenue.

(iii) Taxes on circumstances and property and professions and trades should supplement taxation of property in cities.

(iv) In rural areas local rates should be raised to 6¼ per cent of annual value of land.

(v) Taxes on circumstances and property and professions and trades should also be made use of by rural local bodies.

(vi) License fees on tea and betel shops should be levied by municipalities.

(vii) Local authorities should improve the machinery for the collection of revenue.

§4. *FINANCIAL CO-ORDINATION BETWEEN THE LOCAL AUTHORITIES AND PROVINCIAL GOVERNMENTS*

Need for Grants-in-Aid

The preceding pages have made it clear that the present financial arrangements of the local authorities are unsatisfactory and need change. Perhaps nothing is more urgently needed in the field of local financial reform than a change in the financial relations of the local authorities and Provincial Governments. Any such change on scientific lines should result in (i) an increase of primary and secondary education, (ii) increased facilities for medical treatment, (iii) an advance in public health activities, development of means of communication and transportation, and (iv) an extensive development of rural reconstruction.

On what lines should a change in the present financial arrangements between the local authorities and Provincial Governments proceed? The subject is full of difficulty. Any radical suggestion would necessarily invite criticism. We may, however, learn lessons from the financial history of local authorities in England and put in a plea for the adoption of grants-in-aid devised to start a new kind of relationship between the Provincial Governments and the local authorities. The case for grants-in-aid as a measure for the equalization of burdens and placing local finance on a sounder footing has been made out by Sidney Webb on four grounds. They are:

(i) Grants-in-aid are necessary, in the first place, to prevent an extreme inequality of burden between one district and another.

(ii) They are needed to give weight to the suggestions, criticism and authoritative advice by which the central authority seeks to secure greater efficiency and economy of administration.

(iii) The third reason for grants-in-aid is that they furnish the only practicable method, consistent with local autonomy, of bringing to bear upon local administration the wisdom of experience, superiority of knowledge, and breadth of view which, as compared with the administrators of any small town or any rural area, a central executive department cannot fail to acquire, for carrying into effect the general policy which Parliament has prescribed.

(iv) The fourth reason for grants-in-aid is that only by this means can we hope to enforce on all local authorities of the kingdom that national minimum of efficiency in local services which we now see to be indispensable in the national interest.[1]

Advantages of Grants-in-Aid

As pointed out previously, the Provincial Governments have not so far exercised sufficient care, attention, and control in the supervision of local authorities. It is rather unfortunate that people in India think that the greater the direction and control exercised by the Provincial Government the less is the field for local autonomy. This, however, is a shortsighted view. To quote once again Sidney Webb: 'A century of experience has demonstrated that it is undesirable for local authorities to be subject to no administrative control whatsoever from a central authority, for them to be left without independent inspection or audit, without access to centralized experience and specialist knowledge, without any enforcement of the minimum indispensably required for the common weal, and without mitigation of the stupendous inequality of local rates that complete autonomy involves.'[2] No local authority exists by itself.

[1] WEBB, *Grants-in-Aid*, ch. ii, pp. 15–23. [2] ibid., p. 18.

Its financial and administrative policies profoundly affect the trade, industries, tax-burden and life of people living in other areas. Thus in the interests of a uniform and co-ordinated policy grants-in-aid form the most efficacious lever of central control to harmonize the relations of various local authorities *inter se*.

Again the administrative wisdom and wider experience of the Provincial Government can best be made available for local authorities through a system of grants-in-aid. Local authorities, with local fields of vision, may follow a policy which, though it may be beneficial to the locality, may be detrimental to the wider interest of the nation as a whole. Grants-in-aid in England before 1888 were 'in most cases devised', says Lord Balfour of Burleigh, 'with a view of guiding local authorities in the desired direction'. The wayward policy followed by local authorities in India can be largely controlled and guided in the right direction through a judicious system of grants-in-aid. And as grants must always bear some relation to the cost of local services, they afford a lever for improving local administration, both in regard to efficiency and economy.

The equalization of tax-burdens and the enforcement of a 'national minimum' in locally administered services cannot be attained under the present financial arrangement in India. Poor backward districts possess highly inadequate resources and need larger expenditure for the spread of education, provision of hospitals and improved sanitary facilities, and the development of means of communication and transportation. Under such conditions, says Sidney Webb, 'to leave each local authority to pay for its own sanitation, its own schools, its own roads and bridges, its own sick and infirm, and its own aged and poor would mean that some districts would have to incur a rate in the pound ten or even twenty times as great as others'.[1] Hence, in order that poor undeveloped areas may come up to a common minimum standard of adequacy and efficiency of local services, without gross inequality in tax-burdens on individuals, a system of grants-in-aid becomes a supreme necessity.

[1] WEBB, op. cit., p. 17.

Lastly, at the present time, with the development of means of transportation and communication and the advancement of modern science, national life is becoming more closely knit together. Since no Chinese Wall exists between local authorities, national life is profoundly affected by the ignorance, negligence or poverty of an inefficient or a poor area. As Dr Finer aptly remarks: 'No area is bacteria-proof, none is bacteriologically self-contained; no area is criminal-proof, none is burglariously insulated.'[1] Hence in a progressive society the central authority must see that the standard of services performed by local authorities does not fall below the national minimum. If a local authority cannot come up to a certain standard in the efficiency of its services the central authority must come to its help and raise the efficiency. For the ultimate responsibility for the moral and material development of the people must rest with the nation. People living in poor backward areas should not be denied the minimum civic amenities available to those living in rich areas.

In view of the flagrant disregard of the principle of the 'national minimum' in Indian local self-government, Sidney Webb's classic argument for grants-in-aid is worth extensive quotation:

> We cannot allow Little Pedlington to be free, if it chooses, to have as much small-pox and enteric fever—not to say cholera and bubonic plague—as its inhabitants choose to, rather than take preventive measures which they dislike. We have equally no reason to put up with the horrible bad roads which are all they may wish to pay for. If they are permitted to bring up their children in ignorance, to let them be enfeebled by neglected ailments, and to suffer them to be demoralized by evil courses, it is not the Little Pedlingtonites alone who will have to bear the cost of destitution and criminality thus produced. Hence, modern administrative science is forced to recognize that we are all, in the plainest sense, 'members of one another'.[2]

[1] FINER, *English Local Government*, p. 28.
[2] WEBB, op. cit., p. 24.

Grants-in-aid—their Need in India

The history of grants-in-aid in England reveals that they originated to help the rural classes upon whom, with the development of industrialization and commercialization, the increased burden of taxation began to weigh too heavily. The basic and primary reason for the growth of grants-in-aid, says Dr Finer, was 'the decline of agriculture and an unjust local tax system'.[1] In India, under the Reforms of 1919 land revenue became the mainstay of provincial finance. It is difficult to find what percentage of it was spent upon rural education, medical relief, sanitation, building of roads and bridges and rural development in general. But the backward condition of rural areas, lack of proper facilities for education, medical relief and sanitation and the inadequate development of the country roads, all unmistakably prove that very little of it has been returned to the people from whom it was taken. 'The land revenue in India', observed the Taxation Enquiry Committee, 'is still largely a direct impost levied almost solely for provincial purposes. Only a very small fraction of the tax collected from the cultivators is actually used for rural development, and the illiterate ryot is therefore unable to recognize the benefit which he derives from the direct tax he pays.'[2]

Hence in India grants-in-aid must, in the interests of a better distribution of tax-burden between different social classes, different sources of income and different localities, form an integral part of the financial system of the country. Nothing would do more to rehabilitate rural finances, relieve unjust and oppressive tax-burdens and place local finance in its proper relation to provincial finance than a system of grants-in-aid.

Principles of Grants-in-Aid: Percentage Grants and Block Grants

The principles upon which grants should be distributed between the local authorities remain to be considered. One important conclusion may at once be stated. Lord Balfour of Burleigh was of opinion that 'the contribution given should bear some relation to the cost of national service'.[3] The local

[1] FINER, op. cit., p. 429. [2] *Report*, p. 79. See ch. vii.

[3] *Royal Commission on Local Taxation.* Cmd. 638 (1901). Separate Recommendations of Lord Balfour of Burleigh, p. 71.

authorities may receive grants based upon a definite proportion of the expenditure of a service, or a block grant, i.e. a fixed grant of money without the reciprocal obligation of matching half or two-thirds of the cost of the service, as the case may be.

Percentage grants are easy to calculate and flexible in nature. They offer a powerful stimulus to some local authorities to increase their expenditure, as part of their expenditure will be borne by the higher authority. They can easily be controlled by the granting authority without undue interference with the autonomy of the local authorities. But the greatest defect of percentage grants, in a country where the economic conditions of different local authorities differ vastly, is that they perpetuate inequalities of tax-burdens. The percentage which will provide rich areas with wasteful expenditure will not permit the minimum of civic service in poor areas.

A case for percentage grants is, however, sometimes made out on the ground that since local expenditure is voluntary, a local authority which fails to take the best advantage of the central authority is wilfully negligent of its duty and deserves no encouragement. The fallacy of such an argument is clearly shown in cases where the failure of the local authority to take such help is due not to its negligence but to its poverty. It is exactly for improving the efficiency of such local authorities that grants-in-aid are meant.

Lord Balfour of Burleigh in his separate note to the Royal Commission on Local Taxation (1901) advocated the system of block grants.[1] Such grants, said he, should be given for each service taken as a whole and some attempt should be made in the distribution of such grants to equalize the burden of local rates. The principles upon which the grants should be distributed between the local authorities should take into consideration the cost of the services assisted and the economy and efficiency shown in their administration. Further, with a view to equalize the burden of onerous rates between the ratepayers of different areas, such contributions should be based upon the principle of ability.

[1] ibid., p. 73.

Summary

The system of grants-in-aid in India should be approached in the light of these principles. With vast inequalities of local resources and differences in economic conditions, a system of grants-in-aid is the only practicable method of equalizing tax-burdens and introducing the maximum efficiency in the administration of national services. The following general principles for the distribution of grants-in-aid may be classified:

(i) Grants should only be given for 'national' services.[1]

(ii) Grants should bear some relation to the expenditure upon such services. The amount granted to each local authority should depend upon the varying circumstances of each area. In no case should the grant exceed one-half of the total expenditure.[2]

(iii) In order to minimize the inequality of tax-burdens in the provision of national services, the distribution of grants should be so arranged that the poorer districts should be treated with greater liberality than the rich ones.[3]

(iv) The Provincial Government should be given extensive powers to withhold the grants if a certain degree of efficiency is not reached in their administration.

(v) In all cases the Provincial Government should exercise effective control and supervision over the local authorities through an annual inspection and audit.

(vi) Grants should not be given for purposes which will cause an actual rise in the value of immoveable property of the residents of the local area.[4]

(vii) In order that the local authorities may be able to chalk out a programme of uniform development, grants should be fixed for a period of not less than five years. They should be subject to periodic revision after taking into consideration the improvements made by each local authority during the last period.[5]

[1] See (*a*) GRICE, *National and Local Finance*, p. 326.
(*b*) Cmd. 638 (1901), pp. 73–85.

[2] ibid., p. 73. [3] ibid., p. 83.

[4] See Professor Cannan's distinction between 'onerous' and 'beneficial' services. 'Beneficial' services are those 'which cause an actual rise in the value of immoveable property'. ch. i, pp. 31–2.

[5] For the principles of local finance see ch. i, pp. 33–6.

Local Indebtedness: Conditions under which Local Authorities should Borrow

Another important problem affecting the financial relations of local authorities and Provincial Governments is that of local indebtedness. Local debts in the case of western countries have become a common feature of local finance.[1] The expensive character of the activities of local authorities, especially in the field of improvement of means of communication, sanitation, education, clearing of slums and other social services, has made it impossible for them to balance their budgets with taxation alone. Large amounts of money are borrowed to finance such developmental activities.

In India the problems of local indebtedness, except in the case of the Corporations, have not so far come into prominence. But with the growth in the activities of local authorities local indebtedness is bound to play a greater role in local finance. Hence it may be worthwhile to lay down certain principles which the Provincial Government should take into consideration in regulating and controlling the problems of local indebtedness. They may be stated as follows:

(i) Loans should not be allowed to balance budgets. To avoid the unpopularity of increased taxation local authorities might sometimes resort to the easier method of balancing the budgets through loans. Such a practice would place a heavier burden on future taxpayers.

(ii) Loans should only be permitted for projects of real and permanent improvements which cannot be financed out of ordinary revenues.

(iii) Municipalities and district boards, in the interests of general financial security, should not be allowed to raise loans independently. Each loan application should be made to the loan department of the Local Government. The purpose of the loan, the period of repayment, the rate of interest, must all be definitely stated in the loan application.

(iv) Provision should be made for a sinking fund.

(v) If the loan is required for productive works the income from such works should be set apart from the general budget

[1] See GRICE, op. cit., ch. xx.

and should be utilized for the repayment of capital. In other cases provision for the repayment of capital must be made out of the general budget through increased taxation.

(vi) The Provincial Governments should always balance the interests of the present and future generation of taxpayers. It is in the adjustment of the burden between the present and the future that the function of the central authority, says Dr Grice, as the preserver of financial honesty, the alleviation of immediate hardship, and the guardian of the interests of future citizens is brought into play.[1]

(vii) Except in the case of Corporations, the Provincial Governments should directly advance loans to local authorities. Instead of advancing from the provincial revenues, the Provincial Governments should start a Local Authorities Loan Account and loans should be made out of this account. Such a system would have several advantages. It would keep the provincial revenues separate from local debts. It would restrict, control and keep down local debts. The legislative and administrative regulations made in connexion with the Local Authorities Loan Account would provide safeguards against vast borrowing by local authorities. It would not disturb the general rate of interest. Lastly, it would enable the local authorities to borrow easily and cheaply.

Conclusions

The changed basis of financial relationship between the Provincial Governments and local authorities outlined in the course of this chapter would fill an important gap in the financial system of the country. In place of the present uncontrolled and unco-ordinated tax system resulting in inequalities of tax-burdens, we should have a carefully adjusted system of local taxation in harmony with the national system of taxation. The need for such a change was never so urgent as it is now. The increasing tax-burden on trade and industries in recent times demands a more unified and controlled system of taxation than ever before. Moreover, since the same individual has to pay taxes to different tax authorities, central, provincial and local, it is essential that, if the tax-burden is to be distributed on a more

[1] GRICE, op. cit., p. 329.

equitable basis, a greater element of uniformity should be introduced. A policy of functional re-allocation coupled with the system of grants-in-aid would introduce equity, economy and efficiency in local finance and administration.

XIII

SUMMARY AND CONCLUSIONS

§1. *RECENT TENDENCIES IN PROVINCIAL FINANCE AND POLICY*

The scope of public finance in India, as in most other countries, expanded greatly during the second half of the nineteenth century. So long as the East India Company was engaged in wars, the outlay for military purposes exceeded all other expenditure. The economic, social and cultural needs of the masses were largely neglected. After 1858 there were added to the strictly military functions of the Company certain functions which grew out of the Government's famine policy, for example, the building of railways and construction of irrigation works. In course of time, particularly after the Viceroyalty of Lord Curzon (1899–1905), the Government aimed at a new economic policy and has undertaken many constructive economic and social services. Hence in addition to maintaining law and order the Government has recently been charged with the responsibility of assisting actively with the agricultural, industrial and social development of the country.

The expansion of Governmental activity in India has affected the system of provincial finance in four distinct ways. First, the expansion of social, economic and cultural expenditures needed additional revenues. Second, to secure efficient and economical administration the necessity for a satisfactory distribution of functions between the Government of India and the Provinces became imperative. Third, with the re-allocation of functions the necessity for the adjustment of revenues to needs arose. Fourth, it was felt that additional revenues could only be raised by entrusting the Provincial Governments with the responsibility for raising a portion of their revenues.

The history of provincial finance described in chapters ii, iii, iv and v illustrates these four tendencies.

The increasing financial decentralization from 1870 till the

Reforms is the product of these tendencies. Perhaps the fundamental cause underlying these tendencies is what Dr Anstey calls the 'economic unification of India'.[1] With the introduction of railways and improved means of communication the old necessity for a fiscal centralization has passed and the whole nation is now becoming a closely knit social and economic unit.[2]

The most remarkable tendencies in provincial finance during the period may be summed up as the stagnation of revenue, rising expenditure and unbalanced budgets.[3] Most Provincial Governments feverishly pursued the policy of attempting to balance their budgets at all costs. Most of them fought shy of increasing old tax rates or introducing new ones. A policy of rigorous economy was followed; expenditure on public works was curtailed; all salaries were reduced, and expenditure on education and social services was also cut.[4]

The obvious failure to take advantage of certain other sources of revenue, especially the taxation of agricultural incomes or death duties, is partly responsible for the present financial plight of the Provinces.[5] The lack of capital expenditure for the promotion of small-scale industries to attain a better-balanced economic system has crippled the future finances of the Provinces.[6] This timid negative policy of balancing the budget must in the long run decrease the purchasing power of the people and result in a permanent stagnation of revenue.

Nevertheless, certain hopeful improvements in the tax system and economic situation have appeared since the beginning of the Reforms. Land revenue policy has been modified in most Provinces. In the United Provinces it has been brought within legislative control. In certain Provinces legislation has been passed which has lengthened the period between resettlements, limited the percentage increase that may be made at any one resettlement, and restricted the percentage of the net assets of the land that may be taken by land revenue.[7] The aim of tenancy legislation in all Provinces has been to grant greater security of tenure to the cultivating classes, and a reduction in rentals. Since the great depression (1931) the United Provinces

[1] ANSTEY, op. cit., p. 485. [2] ch. i. [3] ch. xi.
[4] chs. x and xi. [5] chs. vii and ix. [6] chs. viii and x.
[7] chs. vii and x.

Government has been annually remitting Rs. 4,11·5 lakhs of rents and Rs. 1,13·06 lakhs of revenue. These remissions are being continued even today.

Perhaps a more striking change in the fiscal policy of the Provincial Governments has been the construction of huge irrigation works. In Sind the total capital expenditure (excluding interest charges) incurred on the Lloyd (Sukkur) Barrage to the end of March, 1935, amounted to Rs. 20·08 crores. In the United Provinces the total capital outlay on the Sarda Canal and the hydro-electric grid scheme amounted to Rs. 12·15 crores (1936).[1] Much expenditure has been incurred to improve agriculture and the economic condition of cultivators. The provincial agricultural departments have introduced improved types and varieties of crops and improved methods of cultivation. The co-operative movement has been strengthened and great assistance has been rendered to the cultivators in relief of indebtedness. The facilities for education have been increased. Efforts have been made to provide better medical aid, and the Provincial Governments are largely responsible for improvements in public health and sanitation.[2] But all these have merely touched the fringe of the problems. A more vigorous policy is needed to emancipate the poverty-stricken millions of India from an undernourished and disease-ridden existence. Is it possible? Can India sustain the burden?

§2. *THE PRESENT OUTLOOK*

The Fundamental Obstacles to the Development of Social Services

The present outlook of provincial finance has mainly been judged from a narrow point of view. The allocation of resources between the Centre and Provinces, retrenchment and the search for new taxes have formed the favourite themes of writers on provincial finance. But behind these problems and at the root of them all lie some fundamental obstacles which check any more rapid advance in the sphere of social services. I am convinced that no change in the system of provincial finance can result in a rapid advancement of the conditions of the life

[1] ch. viii. [2] ch. x.

of the people unless certain fundamental obstacles are removed. Three such obstacles occur to me.

Provincial finance under the Reforms entered a new stage. Though the powers and resources of the Provinces were considerably increased, the intensity and difficulty of the problems of public finance remained unchanged. In chapter i an idea of the size and population of India was given. The task of a Government (whether alien or Indian) in face of the vastness of the area, teeming population, its predominantly rural character and its dependence on the monsoon, and mass illiteracy, is particularly difficult. Hence financial stringency has been the universal complaint of the Provinces and it has seriously hindered the pursuit of a more constructive social or economic development policy. My own conclusion is that a rapid advancement in the economic or social life of India, through any system of public finance or system of Government, is not possible unless the torrential increase in population is stopped. My assertion is supported by Dr Anstey's observation, that 'it must be definitely recognized that general prosperity in India can never be rapidly or substantially increased so long as any increase in the income of individuals is absorbed not by a rise in the standard of life, but by an increase in the population'.[1] Second, the power of the Government in India is overrated. Owing to the absence of the spirit for social services in India all schemes for social and cultural development must always come from the Government.[2] The Government of a country, however strong its finances may be, must necessarily find it a heavy task to inaugurate rapid social uplift. Perhaps if the attention of national leaders had been more directed towards social than political work, many of India's most pressing present-day economic and social problems would by now have been solved. In most other countries the task of social reform services is at least in part deliberately assumed by the people themselves. Therefore it can be concluded that unless the people assume at least part of the responsibility for finding solutions for a more extensive development of social services, reform must necessarily be slow.[3]

[1] ANSTEY, op. cit., p. 474. See ch. i. [2] ch. x. [3] ibid.

Thirdly, the proper place and functions of local authorities in the national tax system have not been realized.[1] The local authorities have not developed their financial resources and have not undertaken responsibility for the organization and development of social services. Instead of using local resources for the provision and improvement of education, public health and medical relief or the improvement of rural and urban means of transportation, we have depended upon our provincial revenues. We reformed and expanded our provincial tax-system, leaving the local taxes as they were, and upon this flimsy foundation we wanted to build a programme for the re-organization and expansion of social services. As a consequence, lack of local initiative has been one of the major forces retarding the progress of social services.

§ 3. *POSSIBLE LINES OF PROGRESS*

Coming to the most desirable lines of progress in provincial finance it may be mentioned that, in spite of the development of large-scale industries and foreign and internal trade, over two-thirds of the people still depend upon agriculture, so that the relations between the State, the landlords and the tenants need urgent revision. No single factor in public finance, whether a change in commercial or tariff policy, or encouragement and organization of large- or small-scale industries, can compare in importance with the revision of land policy.[2] I must emphasize here that a reduction of rentals should not be the only aim of revision. Security of tenure and freedom to cultivate without restrictions and harassment from landlords are no less important for the prosperity of the cultivators.

Today, the need for additional revenues in the Provinces is urgent. The tax system, as a whole, as argued in chapter ix, is regressive. Instead of mitigating the existing inequalities in the distribution of wealth and income, it has actually accentuated them. Under it large property-owners have generally escaped their burden of taxation. Hence progressive income-taxes on agricultural incomes and progressive inheritance taxes are the only taxes which will substantially remove the

[1] ch. xii. [2] ch. vii.

regressive character of the tax system.[1] The tax revenue may also be supplemented by more progression in income-tax rates and by lowering the tax limit to Rs. 1,500.

If the future finances of the Provinces are to be placed on a sounder and healthier basis, the present passive policy of balancing the budgets at all costs must be abandoned. In its stead the Provinces should pursue a policy of social and economic reconstruction and endeavour to spend larger funds for the construction of public works (for example, roads in rural areas), for the encouragement, organization and establishment of small-scale industries and for increasing the productivity of the soil. The execution of this constructive economic policy should be done partly by increased taxation and partly by borrowing.

It is generally agreed that the present unequal economic development of India is responsible for most of the economic ills from which the country is suffering. In chapter i the great disadvantages of the extreme dependence of public finance upon agriculture were laid bare. There are, therefore, strong reasons for an all-round economic development of the country in which the aim should be the attainment of a better balance between agriculture and industry.[2] If this ideal as India's economic goal were definitely accepted, the system of provincial finance would need a re-orientation. A new policy in provincial finance is necessary in which the Government should help within its *limited* power the employment and development of all provincial resources—in men, material, industrial plant and agriculture. Together with the attempt to correct maldistributed tax-burdens and to place the heavier burdens on broader shoulders, it must form an important feature of the system of provincial finance.

In practice the mobilization of national resources is fraught with great difficulties. False national pride or vested interests may lead to the wholehearted adoption of protective tariffs as the most important method to reach the ideal described above. Space forbids discussion of this controversy here. Nevertheless, it is pertinent to quote Dr Anstey that it must not be lightly assumed either that the desired end can be attained simply by fiscal protection, or that the ideal of self-sufficiency implies that foreign trade should be reduced to a minimum.[3]

[1] chs. vii and ix. [2] ch. x. [3] ANSTEY, op. cit., p. 361.

Hence the prime need of the Provinces—whether agricultural or industrially advanced—is to develop and improve agriculture and small-scale industries. The factors for profitable agricultural production and industrial development have been mentioned in chapter x.

Provincial finance, if properly directed, can bring idle resources into employment and in the long run wipe out the chronic financial stringency and put surpluses in place of deficits.

Another line of progress to which attention has been drawn in chapter xii is the need for financial co-ordination between the Provincial Governments and local authorities. The time has passed when it was possible to treat the problems of provincial and local finances in isolation. Today, the slender resources of the Provinces and local authorities must be carefully husbanded if in the end budgets are to be balanced. It is only by pooling the resources of the Provinces as a whole that the inequalities in the resources of poor areas can be minimized and an attempt can be made to reach a national minimum in the provision of essential social services. A carefully planned financial system and a thoroughgoing reorganization of provincial and local finances appear to be the most desirable lines of progress to stimulate education and provide better medical and public health services.

In conclusion it can be said that the future of provincial finance depends not only upon the discovery of new taxes, and inauguration of particular schemes of development or new lines of policy, but in the main upon 'fundamental social reforms and reorganization, directed towards controlling the size of the population, breaking up the existing over-rigid social stratification, stimulating enterprise and energy, promoting education and replacing the forms by the spirit of religion'.[1] It is thus and thus only that provincial finance can be utilized as an engine to help in providing for the hunger-stricken millions of India a decent existence in an unkind world.

[1] ANSTEY, op cit., p. 487.

APPENDIX I

SOME PRINCIPLES OF TAXATION

In this Appendix we propose to discuss briefly some of the important principles in the pure theory of public finance. Although there is no country in which the whole system of taxation is one logically worked out from first principles,[1] yet it can hardly be denied that a knowledge of the leading principles of taxation would greatly help practical financiers in tackling the problems of public finance in a scientific spirit. Hence an examination of some of the principles may not be out of place here.

Benefit Theory of Taxation[2]

Historically, the benefit and ability theories of taxation have led to the introduction of proportional and progressive taxation. The benefit principle of taxation was based on the protection which the individual enjoyed under the State. Since protection was regarded as the chief function of the State, taxes were regarded as insurance premiums which an individual paid to the State for the security of life and property. From this was derived the theory of proportional taxation. In the beginning the theory of proportional taxation was rigid, proportional taxation being taken to mean proportional to income, irrespective of the size of the income. This conception was soon modified by the idea that income below a certain minimum should be exempt. The conception of the minimum of subsistence led to the introduction of the principle of degression in taxation.

The benefit theory is open to two main objections. First, if each person is required to contribute to the State in proportion to the benefit derived by him, two important questions arise: What *are* the benefits derived by him? and, *How* can they be measured? The *measurement* of benefits (for example,

[1] LORD STAMP, op. cit., p. 24.

[2] For a discussion of the 'Ability' and 'Benefit' theories of taxation, see SELIGMAN, *Progressive Taxation in Theory and Practice* (1908).

defence) and their evaluation are problems not easy to solve. Secondly, even if it were possible to overcome this difficulty, the benefit principle would result in gross inequalities of tax burdens, for social expenditure (for example, elementary education) confers much more benefit on poorer people than on those who are better off. If this principle were strictly applied, many social services which benefit mainly the poorer classes would have to be forgone, as the necessary revenue could not be raised by taxation of those classes. But it is socially necessary and advantageous to provide such services. The principle, therefore, breaks down in practical application.

Nevertheless, the benefit principle has wide application in certain fields of public finance. The principle comes into play under betterment schemes, fees and local taxation. The Government often does things, in a business capacity, which could equally be performed by private enterprise. The public utility services render a special service to individuals which demand a payment in return. Such payments, called fees or prices, for public services sometimes contain an element of taxation.[1]

Ability Theory of Taxation

With the change in the functions of the State the benefit theory proved to be unsatisfactory. In a well-known passage of the *Wealth of Nations*, Adam Smith has set forth the functions of the State. According to him the Sovereign has only three duties to attend to: first, the duty of protecting the society from the violence and invasion of other independent societies; secondly, the duty of protecting as far as possible every member of the society from the injustice or oppression of every other member of it, or the duty of establishing an exact administration of justice; and thirdly, the duty of erecting and maintaining certain public works and certain public institutions which it can never be for the interest of any individual or small number of individuals to erect and maintain.

To provide funds for the State to perform these functions Adam Smith enunciated the four celebrated maxims of taxation, briefly known as the maxims of Ability, Certainty, Convenience and Economy. The maxim of ability is a principle of taxation,

[1] See chs. viii and xii.

the three others are administrative rules respecting taxes. The maxim of ability runs as follows:

> The subjects of every State ought to contribute towards the support of the Government as nearly as possible in proportion to their respective abilities, i.e. in proportion to the revenue which they respectively enjoy under the protection of the State.

The principle of ability led to progressive taxation.

The Principle of Minimum Sacrifice

The Smithian principle of ability has been differently interpreted. Property or income or both are selected as the tests of the taxpayer's ability. These are objective standards. John Stuart Mill transformed the objective standard into the subjective measure of 'sacrifice'. 'Equality of taxation', maintained Mill, 'as a maxim of politics means equality of sacrifice.'[1] The ability of the individual to pay taxes was measured by that proportion of his income the loss of which would impose upon him an equal sacrifice as compared with his neighbour.

The doctrine of equality of sacrifice was reinvigorated by Professor Edgeworth, who dropped the conception of equal sacrifice and introduced the idea of minimum sacrifice. 'The use of minimum', he says, 'instead of equal sacrifice enables us to pierce the sort of metaphysical mist which has been raised by the question: Why should the principle be adopted? The question is not embarrassing to those who regard minimum sacrifice as a deduction from the greatest happiness principle which can guide legislation on a great scale.'[2]

Following Edgeworth, Professor Pigou discards Sidgwick's principle of equity—the principle that similar and similarly situated persons ought to be treated equally—in favour of the principle of least sacrifice. He declares that 'we may properly assert that least aggregate sacrifice is the one ultimate principle of taxation'.[3]

[1] MILL, JOHN STUART, *Principles of Political Economy*. Bk. V, ch. ii, section 2.

[2] *Economic Journal*, 1897, p. 566.

[3] PIGOU, A. C., *A Study in Public Finance*, 1929, pp. 60, 61.

The principle of least sacrifice is based on the principle of diminishing marginal utility, which tells us that the utility of money decreases with its further increases to its possessor. The abstraction of Re. 1 from Rs. 10,000 will not inflict the same sacrifice as its abstraction from Rs. 100. Thus concludes Professor Pigou:

> In order to secure least aggregate sacrifice taxes should be so distributed that the marginal utility of the money paid in taxation is equal to all the payers. If the utility of the last penny paid by A were less than that of the last paid by B, a reduction of sacrifice could be secured by transferring a part of B's assessment to the shoulders of A. Thus, the distribution of taxation required to conform to the principle of least aggregate sacrifice is that which makes the *marginal* —not the total—sacrifices borne by all the members of any community equal.[1]

The principle of least aggregate sacrifice carried to its logical conclusion would involve lopping off the tops of all incomes above the minimum income and leaving everybody, after taxation, with equal incomes.[2]

On theoretical grounds the principle of least sacrifice is not much open to criticism. In its practical application to the logical conclusion, as stated above, the principle involves three important considerations, namely:

(i) Its effects on the distribution of wealth,
(ii) Its effects on production, and
(iii) Political practicability.

The lopping of all incomes above the minimum income assumes the complete powers of the State to redistribute wealth, so as to rectify inequality of fortune. Acting on this principle, if we have to raise Rs. 500 crores for State expenditure, we should lop off the top Rs. 500 crores of individuals' incomes until we have the amount. This may result in cutting down all incomes to, say, Rs. 2,000, below which none would pay taxation. Suppose, having cut down all incomes to Rs. 2,000, the State needs another Rs. 100 crores, on the

[1] PIGOU, op. cit., pp. 75–6. [2] ibid., p. 70.

principle of least sacrifice incomes between Rs. 1,500 and Rs. 2,000 will again be entrenched upon, and all incomes may be further reduced to less than Rs. 1,500.

The economic consequences of the principle to the dynamic life of the community would be disastrous.[1] The incentive to saving and enterprise would be lowered and the accumulation of capital would be retarded. For why should an industrialist, when incomes are to be cut down to Rs. 1,500, use his powers or exert special abilities to make Rs. 20,000 or a higher amount? If accumulation of capital has any value in social and economic progress of a nation, the principle of least sacrifice, carried to its logical conclusion, would ultimately make the nation poorer.

Moreover, it is not only accumulation of capital which would be prevented, but private individuals would hesitate to take risks or to launch new enterprises. Thus inventions and improvements which are essential to the progress of society would be hindered.

Hence, supporters of this principle may reach very different practical conclusions according to the amount of weight assigned to these two aspects of the principle. One may like to diminish inequality of incomes and may give a greater weight to the distributional aspect of the principle. Another may wish to maintain the productive system in a certain form and may thus attach greater importance to the production aspect of the principle.

Moreover, the principle assumes the amount to be raised by taxation to be fixed. But the amount to be raised depends upon the activities of the Government.

Lord Stamp rightly observes that the application of least sacrifice in progressive taxation to rectify inequalities in distribution is partly illogical and considerably overemphasized, and if given pre-eminence is misleading and dangerous.[2]

Equilibrium Approach in Public Finance

The work of the great Italian economist, Antonio de Viti de Marco, is an attempt to study public finance from an equilibrium approach. His main thesis is that the phenomena of

[1] LORD STAMP, op. cit., p. 186. [2] ibid., p. 188.

public finance represent an integral part of general economic phenomena.[1]

In Economics we study the activities of an individual directed towards the satisfaction of individual wants. The production of economic goods in a given quantity at a given time represents the general economic problem. In public finance we study the activities of the State directed towards the satisfaction of collective wants through the production of public goods.

Starting from this analogy between the phenomena of economics and public finance, De Viti proceeds upon the assumption that just as an individual is dominated in his actions by the attempt to maximize the satisfaction derived from his economic activities, so the members of a State desire that 'public goods shall be produced according to the law of least cost—because the lower the cost, the smaller will be their tax burden'.[2]

It is upon this foundation that De Viti builds his pure theory of public finance. He transfers the theory of value to public finance. He investigates the conditions 'to which the productive activity of the State must be subjected in order that *the choice of public services which are to be produced, the administration of their respective amounts, the distribution of the cost among the consumers*, etc., may take place according to the principle of the theory of value'.[3] Such an approach to the science of public finance would result in the greatest satisfaction of collective needs with the least possible waste of the efforts and wealth of a community.

In the above analysis of production and consumption of public goods, instead of the individual, the State is the active subject, and in place of *individual* wants we have *collective* wants.

This forms the framework of De Viti's approach to public finance. A closer examination of the theory of the fee and tax shows how an equilibrium approach forms the foundation of a pure theory of public finance.

[1] A. DE VITI DE MARCO, *First Principles of Public Finance* (1936), p. 52.
[2] ibid., p. 35. [3] ibid., p. 36.

'Special' and 'General' Public Services

The satisfaction of collective wants is the chief function of the State. Collective wants are satisfied through the production of public services which may be divided into two broad groups: (i) special public services and (ii) general public services. The criteria of division between special and general public services depend upon whether the supply of the service is 'technically divisible into saleable units' or not. Special public service must be capable of retail sale in any quantity and at any moment. General public services on account of their character are not capable of division into saleable units. This criterion gives rise to the phenomenon of the fee.[1]

The theory of the fee has been discussed in detail in chapter ix. There it has been pointed out that in the supply of these services an exchange relationship between the State and the individual is established. The State charges a 'public price' for a 'public service'. This price is called fee.

No exchange relationship can be established for the supply of general public services, e.g. the defence of the country. For such services the State levies a tax. A tax is a compulsory contribution demanded by the State for the supply of general public services consumed by an individual.

The fundamental distinction between a fee and a tax arises from the fact that in the case of the fee it is possible to distribute the cost of the special public services among the consumers according to the actual consumption of the service; while in the case of the tax this is not possible as the consumption of general public services is an indeterminate amount. The problem of public finance is to distribute the cost of the indivisible benefit of general public services among the members of the community. It is here that Dr Benham develops the concept of 'neutrality' to explain the distribution of tax-burden.

'Neutral' System of Taxation—An Ideal System

'A neutral system of taxation and public expenditure', observes Dr Benham, 'is one which translates into effect the voluntary judgements and preferences of the citizens, whatever

[1] See ch. ix.

they may be.' In such a system of taxation 'the difficulties of defining ends, of weighing them, of considering other effects, are evaded by the simple process of accepting whatever decisions the citizens themselves make'.[1] The way to discover what a neutral system of taxation would be is to consider what would happen if instead of the State performing certain services they were collectively performed by a group of men.

One can conceive of the existence of a group of men in a small area without a State. In this isolated society an individual will feel the need that his person and his goods should be defended against external attack or against the other members of his group. The community may provide an army or guards. Later on, to solve the disputes between him and other members, the community may provide law and order. The benefit from these services is indivisible. If we assume that each individual of such a community has equal income and tastes, each person, in these circumstances, might agree to contribute an equal amount towards the collective provision of such services provided that all his fellows did the same. Offenders who failed to pay the contribution would be penalized. The taxation in such a case would reflect the voluntary judgements and preferences of individuals and would be neutral. There would be no force as each member might deem it to his advantage to restrict his freedom of expenditure as all his fellows were doing the same.

But with the development of economic, ethical and political ties need will be felt for other services, for example road construction and maintenance, public instruction, supply of water, etc. The benefit of these services is divisible. Suppose these services are sold by private entrepreneurs who charge from each consumer a price corresponding to the amount of the service consumed, for example providing roads and charging tolls. But the inconvenience of frequent stoppages would soon lead the people to think that it is better to have free roads and to meet the cost by taxation.

The coming of the State for providing these services 'will introduce no disturbing force. Each person will prefer the new situation to the old one. And it will be noted that all this

[1] BENHAM, F., 'Notes on the Pure Theory of Public Finance', *Economica*, November 1934, p. 445. All page references are to this.

involves no interpersonal comparison or addition of utilities, such as is sometimes implied in the concept of "collective wants". Each acts according to his own preference'.[1]

Now if we discard the conception of equal incomes and tastes, the new situation will make no difference in our analysis. Different persons will demand the collective wants in different amounts. But 'men with equal tastes', says Benham, 'may be prepared to pay different amounts towards a collective service because their incomes are different. Similarly with men of equal incomes whose tastes, including those arising from their different locations or occupations, are different. For *the amount of collective expenditure which a person desires will vary with the proportion of the total cost which he has to pay*'.[2]

Dr Benham makes the above statement on the presumption that all the members in the community consume collective services. This corresponds with reality. Everybody derives benefit from the State protection of life and property. Everybody shares in the indivisible benefits of general public services. Those who disclaim these benefits (and consequently refuse tax payments) are in De Viti de Marco's words a pathological group against which the society must defend itself.[3]

It is on the above lines that Dr Benham develops his theory of neutrality in taxation. This theory assumes that the various preferences of citizens are 'correctly mirrored by their representatives in Parliament'. It is based on democratic Government. 'Periodical elections, constant criticism from the Press and organized groups, the habit of making concessions to minorities,

[1] BENHAM, op. cit., p. 452.

[2] BENHAM, op. cit., p. 453. To the above analysis it may be objected that as *the consumption of general public services is not proportional to the income of each citizen*, the principle of neutrality breaks down. A little reflection, however, will show that this is not the case. Since income is the best single measure of judging the ability of an individual to consume general public services, we may justify our presumption by saying that if group 1 demands and consumes twice as much public services as compared with group 2, it is merely because the income of group 1 is twice as much as that of group 2. It is quite likely that group 1 may not consume, at a given moment, services on objects, say A and B, and group 2 on objects C and D. But in a long period of time, for example, a generation, difference of the total consumption of public services between groups 1 and 2 will diminish or disappear.

[3] DE VITI, op. cit., p. 114.

usually ensures that no substantial body of opinion is for long in sharp disagreement with the whole system of public finance which prevails.'[1]

The conclusions of this analysis are in no way vitiated by objections like: What about benefits to persons suffering from sickness, unemployment or old age? Men who are not able-bodied can be helped either by voluntary aid or by special State provision: for example the State might for the sake of society as a whole, and with general consent, (i) exempt from taxation incomes below a certain level, and (ii) assist from general taxation those whose incomes do not reach the minimum subsistence level. There is nothing in the concept of neutrality to exclude what Dr Benham calls a 'social conscience'. Moreover, when the incomes and tastes of individuals differ, the State, as pointed out previously, can follow a policy of discrimination in charging different prices to different people for special public services.

Despite the fact that no completely neutral system of public finance exists or ever existed, the conclusion cannot be avoided that this concept of neutral taxation is one of the most eloquent contributions in the pure theory of public finance.

The Best Tax Scheme

Having discussed the ideal tax system from a theoretical point of view, let us work out a tax scheme which may be best in practical application. The object of such a scheme should be to increase the prosperity of a nation. 'Prosperity', says Dr Benham, 'is the state or condition of being more or less "well-off" in a strictly *material* sense.'[2] There are innumerable factors which influence the prosperity of a nation. Thus climatic conditions (especially rainfall in the case of India), natural resources, industrial and agricultural development, transport facilities, monetary and banking policy, the machinery of public finance, the system of government, education, health and a hundred other factors may influence the prosperity of a nation. A discussion of all these factors is beyond the scope of this work. Hence we shall try to show how the prosperity of a nation is influenced through the machinery of public finance.

[1] BENHAM, op. cit., p. 455.

[2] BENHAM, F., *The Prosperity of Australia* (1930), p. 1.

The system of public finance can influence the prosperity of a nation essentially in two ways: (i) reducing inequality of incomes, and (ii) influencing the system of production. The mode in which the national income is distributed among the members of the community affects prosperity. It is often the case that while the total national income is great, the way in which it is shared out is not even. Thus a small percentage of the income-receiving population may take a large proportion of the total, whilst a large percentage may receive a small proportion. The general opinion of economists is that 'whilst some inequality is both desirable and inevitable, *great* inequality is a waste of material welfare'.[1] Thus public finance can increase prosperity by altering the unevenness which usually prevails in the distribution of national income.

Public finance also affects the system of production in a country. It may injure future production. The tariff policy of a country may result in a diversion of labour and capital from more profitable employments to less profitable employments. A high rate of income-tax may lead to some diminution in the growth of capital. The tax system may encourage the growth of monopolies. On the other hand, a well-operated system of public finance may increase the volume of production with the result that the increased size of national income may, on an average, give a larger share to each member of the community.

Thus the best system of taxation to increase the prosperity of a nation should increase its volume of production as well as secure a better distribution of national income. As stated previously, since taxation in practice represents practical compromise, no scheme of taxation can secure absolute scientific precision in the application of the above two principles. To every tax-system objections can be raised; our object is to indicate a well-balanced system, coming nearest to the realization of the above two principles, which is least objectionable and most effective.

[1] BENHAM, op. cit., p. 11.

Reducing Inequality of Incomes

The problem of reducing the inequality of incomes raises four questions: (i) *Why* should the State reduce the inequality of incomes? (ii) To what *extent* should the inequality be removed? (iii) In what *way* can the inequality be minimized? and (iv) What *machinery* should be employed to reduce inequality? We shall consider each of these questions in turn.

'Taxation for revenue only' was a Victorian slogan of public finance. Taxation for objects other than revenue was considered impolitic or wrong. The common opinion was that it was no part of the duty of the State to 'readjust the vicissitudes of fortune'. But public opinion of late has changed, and taxation now is justified as an engine for redistribution of wealth. The reason for this, to use the words of Dr Benham, is that 'since prosperity is, ultimately, a state or condition, a given national income would "go further" if it were *somewhat* less unevenly distributed than is often the case in modern communities'.[1] Hence taxation in modern States is not always swayed by revenue considerations. The State, to increase the prosperity of the nation, aims at a more equitable distribution of wealth.

This change in attitude towards taxation is primarily due to the enlarged conception of 'equity'. 'Equity', Professor Marshall says, as 'an adequate guide in the philosophy of taxation', was based on the principle of *existing rights*; 'it was generally considered equitable that everyone should contribute' on the joint-stock plan to the expenses of the State. So that, if taxation aimed at redistribution of wealth it was manifestly wrong and unjustifiable. This conception later on was changed, and it was generally recognized, to quote Professor Marshall again, that 'though a joint-stock company must accept them [existing rights] as final, the State is under obligation to go behind them; to inquire which of them are based on convention or accident rather than fundamental moral principle; and to use its powers for promoting such economic and social adjustments as will make for the well-being of the people at large'.[2]

[1] BENHAM, op. cit., p. 11.

[2] MARSHALL, ALFRED, *National Taxation after the War.* This forms chapter xviii in *After War Problems*, edited by William Harbutt Dawson (1917), p. 317.

A National Minimum Income

This brings us to the second question. To what extent should the State reduce inequality of incomes? Here we are at once faced with a difficulty. On the question of what ought to be the functions of the State people may differ. For this is a matter of opinion, and economic analysis cannot prove that one opinion is right and another wrong. A socialist may advocate complete equality of incomes to achieve a social millennium. But there is grave danger that drastic changes in the redistribution of income may check economic progress and may curtail the volume of production per head. Hence we think it desirable to state (to avoid these controversial matters) that within the framework of capitalism, the State should try to achieve the ideal of providing every citizen with a national minimum real income.

Before stating how to achieve this, it is desirable to signify what precisely is meant by a national minimum standard of real income. 'It must be conceived', says Professor Pigou, 'not as a subjective minimum of satisfaction, but as an objective minimum of conditions. The conditions, too, must be conditions, not in respect of one aspect of life only, but in general.'[1] The determinants of a national minimum income have been stated by Dr Benham under four heads. Briefly they are:

> (i) The provision of adequate food, clothing, medical attention, education, and other essentials, for all *children.* (This would reduce the influence of environment and opportunity in causing the differences in earnings which explains, to some extent, the gulf between the haves and the have-nots.)
>
> (ii) The removal of the haunting shadow of *insecurity* which darkens many lives.
>
> (iii) The reduction of *inequality of incomes* through the machinery of public finance.
>
> (iv) The improvement of *productive capacity* through greater public expenditure, chiefly upon health (and especially preventive measures) and education.[2]

[1] PIGOU, A. C., *The Economics of Welfare*, p. 714.

[2] BENHAM, op. cit., pp. 240–1.

The provision of a national minimum income, taking all the above factors together, could be achieved by transferences of national income from the relatively rich to the relatively poor. A detailed discussion of these heads is clearly beyond the scope of a work on provincial finance in India. However, we shall indicate the different types of transferences effected in a modern State.

These transferences can be grouped under two heads: first, those which increase the income of the citizen directly. The transferences in the form of pensions, unemployment insurance, and poor relief, would come under this head. The tacit assumption underlying the State expenditure on education, health, medical, and similar services is based on the expectation that the poorer members of the community will derive greater benefit from these services than the rich. The transference of national income in the form of services in favour of the poor is a growing proportion of the national expenditure. But here there is one difficulty. In practice it is not possible to set up a standard which a person must satisfy before he is entitled to the benefit of these services. The result is that these services benefit equally different persons (rich and poor) whose circumstances are substantially different. Mrs Hicks writes, for example: 'The extent to which the social services imply a redistribution of the national income from the richer to the poor part of the community naturally differs very much from one service to another, as it does from one country to another.'[1] In ideal conditions a separate standard capacity would be fixed for different groups into which the community may be classified. Thus, persons having a certain income alone should be entitled to use, say, education and medical services provided out of national income. The redistributive character of the plan would depend upon the skill of the classifying authorities, and the co-operation between the Government and the governed.

[1] HICKS, U. K., *The Finance of British Government, 1920–36* (Oxford University Press) 1938, p. 56.

The Case for a Single Tax

Having indicated the reasons, the extent and the methods by which the State attempts to reduce inequality of incomes, we now turn to the most important field of our inquiry, namely, what machinery should the State employ to reduce inequality of incomes? This is the most complicated matter. The State in a great number of ways and for a great variety of reasons raises its revenue. Here we have to evolve a scheme which shall increase national prosperity. We have to discuss the problems of the distribution of taxation.

Some writers cherished the idea of a single tax on land values. The Physiocrats advocated a single tax 'on the net product of the soil'. Their argument is that since the amount of land is limited and the increment in the value of land is due to the 'progress of the society', a tax on land value justly belongs to the State and should pay all its expenses. The arguments against the single tax on land values are too well known and need not be repeated. Today, little is heard of this proposal.

This idea of a single tax on land values has been followed by proposals for a single tax on 'expenditure'; a single tax on 'capital'; a single tax on 'income', etc., etc. The most popular single tax that is discussed nowadays is the single tax on income. On this point I cannot do better than quote Dr Benham's words: 'There is a much stronger theoretical case for a tax on income. For income is the best single measure of ability to pay, and if income alone were taxed, the Government would be able to decide exactly how much a man with a given income should pay. If it wished, it could exempt altogether incomes below a certain level, it could tax incomes from property more heavily than incomes from works, it could allow deduction for children, and so on.'[1]

If there were only an income-tax, a taxpayer, after paying the tax, would be at liberty to spend his income in whatever way he chose. As it is, taxation of commodities penalizes the consumers who happen to use the taxed commodities as compared with those who do not. Thus the taxation of salt and sugar hits the income of a poorer man much more than that of

[1] BENHAM, op. cit., p. 305.

a rich man. Such taxation cannot be 'progressive'; it is not even 'proportional' to the total incomes of the two; it is proportional to the amount spent by each over these objects. But as a man earning say Rs. 50, buys much more of the taxed commodities than the rich man, the former pays much more in taxation though he pays nothing in income-tax. A single tax on income would be free from all these defects.

Perhaps the greatest limitation to the proposal for a single tax on income is that it is not possible to ascertain the total income of every citizen. As Professor de Viti says: 'If a synthetic method were available for the ascertainment of the total income of every citizen with uniform results, the single tax would solve the problem of simplification. But the concrete problem resides precisely in making the hypothesis a reality.'[1] Moreover, if the income-tax were increased, and other taxes abolished, the burden upon the taxpayers may appear to be too heavy and may result in fraud and evasion. Income-tax, in Gladstone's words, was bad because it made a 'nation of liars'. Hence, a single tax on income, though theoretically sound, is on the grounds of 'workability' exposed to dangers. In this connexion the observation of Lord Stamp may be quoted with profit: 'It may be taken as axiomatic that the more closely the tax conforms to just principles the more open it will be to evasion, and the problem for the State is always how closely to conform to principle without giving up its safeguards.'[2]

From this we may conclude that in order that no income escape taxation and the tax scheme be practicable, the single tax on income must be supplemented by other taxes. This is done in most modern States through a system of manifold taxes, which consists in the transformation of a single tax into various taxes. The system differentiates income into several sub-categories—as, for example, 'income spent', or 'income saved'; or again, income from land, from capital, from trade and industry, from professions. For each type of income a different rate may be fixed; the object being to increase or decrease the tax-burden on some classes of income as compared with others.

[1] De Viti, op. cit., p. 206. [2] Stamp, op. cit., p. 119.

A Manifold Tax System

Differentiation is usually achieved by dividing the tax system into direct and indirect taxes. The criteria for distinguishing between these two types of taxes have given rise to much controversy, but need not detain us here. Each basis of distinction is open to some criticism. Thus John Stuart Mill's definition, to take only one example, of a direct tax as one 'demanded from the very persons who, it is intended, or desired, should pay it', and an indirect tax as one 'demanded from one person in the expectation and intention that he shall indemnify himself at the expense of another', does not always square with actual facts.[1]

Perhaps the best way to get out of these difficulties is to look at the division from the point of view of practical administration, which has reference to the method of *collection.* According to this criterion a direct tax is one which is levied at fixed intervals from persons whose names are known to the tax authorities. Indirect taxes are levied on the occasion of certain definite acts, which do not fall at fixed intervals and do not require the lists of names of taxpayers. An elaboration of this discussion is not relevant to our subject.

The main object of the introduction of direct and indirect taxes is to divide the taxpayer's fiscal obligation into several parts; part of which he must pay by direct taxes and part by indirect taxes. It is easy to show how a tax system, where both direct and indirect taxes exist side by side, is superior to one where only one of them exists. The outstanding problem is the distribution of the burden in reality on some principles. From what has been said before, it follows that the most important principle is to tax according to ability to pay. Indisputable as this principle is, in its practical application many difficult issues confront us. In measuring ability to pay we not only take certain objective attributes as *indicia* but also something which relates solely to the subjective side of human life. For example, the exemption of the minimum income from taxation is based on humanitarian as well as economic grounds. The really important question, therefore, before us is what tests should be applied to measure ability and what relative importance should

[1] MILL, *Principles of Political Economy*, p. 423.

be attached to each of them. Four such tests of ability readily occur to one. They are:

(i) Net income.
(ii) Net assets.
(iii) Expenditure.
(iv) Special ability.

We shall discuss each of these, one by one.

Tests of 'Ability' to Pay: (i) *'Income' as a Test of Ability*

It has been shown that *income* is the best single test of ability to pay. But as income sometimes depends on the assets of an individual, assets may be taken as the second test of ability.

Income is always measured over *a period of time*; a week, a month, or a year. It may arise from the labour of the worker himself (e.g. wages, salaries, fees); it may be due to the assets of the person (e.g. interest, rents, dividends); or lastly, it may arise as a result of State policy (e.g. pensions or unemployment allowances). Thus, an individual may receive income from either of the first two sources or both of them. Income arising from the third source is merely a redistribution of a portion of the national income raised through taxation among certain sections of the community.

Income as a test of ability may be taken to mean the *net receipts* of an individual from all sources during a given period of time. Thus the business expenses of a manufacturer, or the cost of maintaining property, or other expenses to maintain capital intact, should be deducted before finding the net receipts available for taxation. Similarly, it is commonly recognized that to maintain human capital intact, a certain minimum expenditure on food, clothing, housing and other necessaries for efficiency should be exempted from taxation. In fact, the income-tax law of practically every country exempts a certain minimum income from taxation.

It is important to remember, however, that before ability can properly be tested by net income, the factor of time should be taken into account. 'We are so used to considering income "by the year" that it seems to be almost an ordinance of nature.'[1]

[1] STAMP, op. cit., p. 27.

Yet income fluctuates from year to year. A tax system that does not take into consideration a proper unit of time for a particular type of income is bound to be inequitable. To take one example: the British income-tax differentiates against industries whose profits fluctuate over time as compared with those that are stable. This will appear from the following table:

YEAR	INCOME OF FIRM I	SURTAX	INCOME OF FIRM II	SURTAX
1	£2,000	0	£10,000	£1,519-7-6
2	£3,000	£61-17-6		
3	£25,000	£6,469- 7-6		
4	£4,000	£171-17-6		
5	£16,000	£3,361-17-6		
	£50,000	£10,065- 0-0	£50,000	£7,596-17-6

It is clear from the above table that firm I, whose income fluctuates from year to year, pays more in surtax than firm II during a period of five years.

It is not possible to suggest a definite period of time which may be suitable for all types of incomes. However, a three or five years' average system would give power to an individual to carry over his income. In an agricultural country, where agricultural conditions fluctuate from year to year, a five years' period would perhaps be suitable.

(ii) *Assets as a Test of Ability*

The assets of an individual at a certain point of time represent the market value of all his possessions, plus the value of the debts receivable by him and minus the value of the debts payable from him. The assets of an individual may be in various forms; they may range from stocks and shares, land and buildings, and hoarded money, to jewellery, ornaments and furniture.

The assets of an individual are of less importance than his income as a test of ability. In the first place, a part of his assets cannot be taxed. A person who locks up Rs. 10,000 in diamonds escapes the payment of tax on that amount during his lifetime. Thus assets of the type of hoarded money (a

common type in India), jewellery, ornaments, furniture or other non-income-yielding assets are outside the pale of taxation during a certain period of time. In the second place, the appraisal of the revenue-yield from assets is a matter of difficulty. No doubt in some cases the yield from the assets is deducted at the source; but in some cases, either through fraud or understatement, it escapes detection. Moreover, reappraisals of incomes from certain types of assets cannot be made as rapidly as the incomes vary. Thus, while the tax on land or buildings is fixed for long periods, the incomes vary meanwhile.

Nevertheless, assets are a useful test of ability on certain occasions. They give rise to the distinction between 'earned' and 'unearned' income. The reasons for giving favoured treatment to earned income depend upon the fact that its continuance depends upon the effort of the particular person. It stops when he ceases to work. Such a person has to make various personal and domestic allowances. The possession of capital thus affects 'ability to pay' in incomes. Taxes on capital transactions and transfers of property (in the shape of stamp duties) represent indirect taxes on savings and are justified on the score of assets as a test of ability. Finally, assets are a useful test of ability in death duties.[1]

(iii) *Expenditure as a Test of Ability*

The first two tests of ability—net income and net assets —present few difficulties. Expenditure as a test of ability, in capitalistic countries with sharp inequalities in income and assets, creates differentiation in taxation. In the search for the exemption of savings from taxation, Professor Pigou considers the possibility of a general expenditure tax. 'If that part of income', says he, 'which is devoted to the purchase of consumable goods and services, as distinct from capital goods and services, is taxed, and the rest left untaxed, we shall obviously have a tax system under which "spent" income is taxed and "saved" income exempted.'[2] Logically, an expenditure tax would exempt savings from taxation. Apart from the considerations whether the exemption of savings is desirable or not (to them we return

[1] See ch. ix, pp. 201-9 for a fuller discussion of death duties.

[2] PIGOU, *op. cit.*, p. 141.

in another section), the practical difficulties in the successful working of the tax rule it out of court. We have, therefore, to inquire whether it is desirable to have expenditure as a subsidiary test of ability without causing too much tax differentiation.

It is universally recognized that every individual, to realize that he is a citizen, must pay some tax towards the cost of the State. Direct taxation of the income of the poorer classes, even roughly to conform to the principle of ability, is difficult and troublesome. Its assessment and collection will need an army of collectors and may leave a wide door open for evasion and fraud. The administrative costs may ultimately be higher than receipts. Hence a tax on expenditure in the shape of indirect taxes is levied. Excise duties and customs are the most common examples of indirect taxes.

In addition to the administrative difficulties another reason for the levy of taxes on commodities is the practical one of plucking the goose with the least squealing. The tax is wrapped up in the price of a commodity and hence causes much less resentment among the taxpayers than would be caused by an equal amount raised through direct taxation.

Theoretically, it would be ideal to have a progressive expenditure tax; in it 'it would be necessary to impose upon each commodity, not a single rate, but a number of different rates adjusted to the incomes of the various purchasers'.[1] Such an arrangement, however, is practically impossible. Hence we have *ad valorem* or *specific* duties. Here difficulties arise. *Ad valorem* commodity taxes, though proportionate, are actually regressive; the ratio of the tax is different to different incomes. Thus, if everybody's expense on certain taxed articles were the same, irrespective of the size of their incomes, the rates of the taxes borne by them would vary inversely to the size of their incomes; for example, if the tax is 1 pice in the rupee for an income of Rs. 1,000; it would be 2 pice in the rupee for an income of Rs. 500; 1 anna in the rupee for an income of Rs. 250; and 2 annas in the rupee for an income of Rs. 125.

There are, however, more serious objections than this. Experience shows that the poor, as a class, by reason of family

[1] PIGOU, op. cit., p. 142.

obligations, consume a larger quantity of lucrative revenue-yielders (i.e. necessaries of life) than the rich, and, therefore, pay not only a higher rate of tax, but also absolutely more. Moreover, as most taxes in practice are *specific*, the poor pay more by consuming articles of an *inferior* quality.

There are many other defects of expenditure as a test of ability. Some might object to it as it does not take into account what Lord Stamp calls the 'domestic circumstances' of the taxpayer; others might say that it fails to do justice as it does not discriminate between earned and unearned incomes; still others might contend that as it does not tax net assets it is leaving out an important test of ability. But few would deny that as a supplementary test of ability *some* weight should be given to it. It is a minor test of ability. In practice, unfortunately, those who direct public affairs, through ignorance, party politics, national pride or vested interests, attach undue importance to expenditure taxes. Other considerations outweigh economic reasons. The result is that the tax system of the country becomes regressive instead of progressive. This ultimately must react on the prosperity of the nation. In such a case the most obvious remedy is to arouse the electorate to demand from the statesmen the course of policy which shall serve their interests best.

(iv) *Special Ability*

Net income, net assets and expenditure as tests of ability should be supplemented by special ability. Special ability should be applied in relation to the taxation of windfalls. By 'windfalls', Professor Pigou means 'accretions to the real value of peoples' property that are not foreseen by them and are not in any degree due to efforts made, intelligence exercised, risks borne, or capital invested by them'.[1] The special ability principle may be applied in the case of both income and assets. Thus irregular or spasmodic receipts do not require the same sacrifice or efforts as does regular income, and possess a higher degree of ability. The taxation of the increment in land values due to the progress of society, or the excess profits earned during war time, or windfalls

[1] PIGOU, *op. cit.*, p. 177.

due to lotteries, fall under the special ability principle. Similarly, the taxation of big inheritances may also be looked at from this point of view.

As under the principle only extraordinary gains in income or capital would come under taxation, the principle as a test of ability is of minor importance. Nevertheless, it is peculiarly suitable for application on certain occasions.

The Tax System must be Progressive

Finally, progression must form the most prominent feature in the tax system of every country. The reduction of inequality of incomes is attempted through progression. Whether it is the taxation of income or assets, progression is universally applied. It is also of help in the application of the special ability principle. A rough approximation to progression is attempted in expenditure-taxes by taxing articles mainly consumed by the rich at higher rates than those consumed by the poor. We have placed progression last not because it is of least importance, but because it is the universal principle which should be applied in all the tests of ability. The arguments for this have been discussed in pages 304–6.

Income-Tax and Savings

Into the wider question how taxation affects the productive system in a country, it is not possible to enter here. As income forms the principal test of ability in the tax scheme described above, I shall briefly consider the disputed question whether an income-tax discriminates against savings or not.

There is no unanimity of opinion among economists on this point.[1] Professor Pigou is of the opinion that a permanent general income-tax discriminates against savings. Professor Cannan, Dr Benham, Professor de Viti and Lord Stamp put forward the contrary view. Let us briefly state the main arguments of each view.

Professor Pigou contrasts the effects of a permanent expenditure-tax (i.e. a tax on consumed income) with a permanent

[1] See PIGOU, op. cit., p. 136; BENHAM, *Economica*, November, 1934; STAMP, op. cit., pp. 58-61. See also *Economic Journal*, 1935 (Sept.), GUILLEBAUD's article on Income-Tax.

general income-tax. He says: 'Under the former, resources that are saved are taxed indirectly, through their subsequent yield, to the same extent as resources that are consumed at once. There is, therefore, no differentiation of any kind. An income-tax, on the other hand, differentiates against saving, by striking savings both when they are made and also when they yield their fruits. Thus a general permanent income-tax at the rate of x per cent, strikes the part of income that is spent at this rate. But, if £100 of income is put away from saving, it removes £x from it at the moment and, thereafter, removes also some part of the fruits yielded by it.'[1] The opposite view has been plainly put by Lord Stamp. 'Let us assume that a man saves £100 and at the end of ten years has had £5 per annum, and still having his £100 he then spends it. He pays tax in all upon £150 either under the present system, when his tax is on the £100 at first and the £50 by annual instalments afterwards, or under an alternative system of taxation on expenditure, where he pays on £5 per year for ten years and £100 in the tenth.'[2]

Professor Pigou in the above view is mistaken in assuming that savings are never withdrawn for spending. For, as Dr Benham has pointed out 'it can be urged that in order to make a complete comparison between the two taxes in question, we must consider the whole cycle—accumulation of capital, receipt and expenditure of interest, and withdrawal and expenditure of capital. It then seems that if an income-tax can be said to strike savings twice, so can a general expenditure-tax. The former strikes them when they are made, and when interest on them is received, but not when they are withdrawn and spent. The latter does not strike them when they are made, but it does strike them both when interest on them is spent and when the savings are withdrawn and spent'[3]

The issue, perhaps, can be clarified by means of an arithmetical example. With 5 per cent rate of interest £100 saved will become £105 in a year. If there is no income-tax this will remain £105. If income-tax is 20 per cent, £100 saved will become only £104. Now suppose there is a sales tax of 20 per cent. £100 spent now are worth £80. £105 spent at the end

[1] PIGOU, op. cit., p. 136. [2] STAMP, op. cit., p. 60.
[3] BENHAM, op cit. p. 442.

of a year are worth £84.[1] Thus the terms of exchange are unaltered whether there is an income-tax or sales tax, for 80:84:: 100:105. Hence an income-tax on savings does not discriminate against savings.

Conclusion

Our brief survey of the broad characteristics of the scheme has demonstrated the possible ways in which the tax burden of a country may be distributed. But the practical difficulty remains. Various sets of weights may be assigned to each test. One set of weights may yield quite a different result from another. Moreover, the set of weights would differ between times and places. For each country various compromises may be possible. Clearly the differences in results in each compromise would reflect the effect of the weights assigned to each test. As time goes on the weights may have to be changed. For example, the real income of the population or the character of its distribution among the people may change. People may spend a larger proportion of their incomes on objects which formerly used to be considered as luxuries (for example, motor-cars, radios, expensive dresses, and so on). The sharp inequalities in income and property may change. This may give scope for commodity taxes to play a dominant part; for taxes on expenditure are less regressive when objects of taxation are luxuries or where a considerable majority of the members in a community are about equally wealthy. In times of war, when business men are making high windfall profits, the special ability test should be assigned a greater weight. The industrial revolution increased the total volume of production in England but created a wider gulf between haves and have-nots. The necessity for a heavier weight to net income was clearly visible in those days. One conclusion which emerges from all this is that the practical application of the tests will differ between times and places; and the tax system, though largely dependent upon the tests indicated above, will be to some extent arbitrary.

Nevertheless, it may be stated that, to make the tax system

[1] It is assumed here that savings are withdrawn for spending and a tax is paid on them.

of a country progressive, greater weight ought to be attached to direct taxes. Taxation of net income and net assets appears to be the most desirable lines of action. Thus income-tax, corporation tax, super-tax and death duties should be, among others, the most important sources of revenue for the State. To tax the incomes of the poor classes, so that everybody should contribute something towards the expenses of the State, indirect taxes should be imposed. Taxation of a few necessaries of life, through customs or excises, should form an important feature of the tax system. In selecting the necessaries of life it must always be kept in mind that unnecessary hardship must not be caused to the poorer classes. Taxation of luxuries should also be made to contribute a substantial portion of the revenues of the State.

In practice, to evolve a tax system free from all possible defects is almost an impossible task. For one thing taxation is a matter of expediency. For another no finance minister can suddenly break through the established tax system. Finally, it would be difficult to estimate exactly the incidence of each tax. Hence the aim of the finance minister should be to make the system progressive. The justice or injustice of the tax system essentially lies in whether it is progressive or regressive.

APPENDIX II

LEGISLATIVE LISTS

1. FEDERAL LEGISLATIVE LIST

1. His Majesty's naval, military and air forces borne on the Indian establishment and any other armed force raised in India by the Crown, not being forces raised for employment in Indian States or military or armed police maintained by Provincial Governments; any armed forces which are not forces of His Majesty but are attached to or operating with any of His Majesty's naval, military or air forces borne on the Indian establishment; central intelligence bureau; preventive detention in British India for reasons of State connected with defence, external affairs, or the discharge of the functions of the Crown in its relations with Indian States.

2. Naval, military and air force works; local self-government in cantonment areas (not being cantonment areas of Indian State troops), the regulation of house accommodation in such areas, and, within British India, the delimitation of such areas.

3. External affairs; the implementing of treaties and agreements with other countries; extradition, including the surrender of criminals and accused persons to parts of His Majesty's dominions outside India.

4. Ecclesiastical affairs, including European cemeteries.

5. Currency, coinage and legal tender.

6. Public debt of the Federation.

7. Posts and telegraphs, including telephones, wireless, broadcasting, and other like forms of communication; Post Office Savings Bank.

8. Federal Public Services and Federal Public Service Commission.

9. Federal pensions, that is to say, pensions payable by the Federation or out of Federal revenues.

10. Works, lands and buildings vested in, or in the possession of, His Majesty for the purposes of the Federation (not being naval, military or air force works), but, as regards property situate in a province, subject always to Provincial legislation, save in so far as Federal law otherwise provides, and, as regards property in a Federated State held by virtue of any lease or agreement with that State, subject to the terms of that lease or agreement.

11. The Imperial Library, the Indian Museum, the Imperial War Museum, the Victoria Memorial, and any similar institution controlled or financed by the Federation.

12. Federal agencies and institutes for the following purposes, that is to say, for research, for professional or technical training, or for the promotion of special studies.

13. The Benares Hindu University and Aligarh Muslim University.

14. The Survey of India, the Geological, Botanical and Zoological Surveys of India; Federal meteorological organizations.

15. Ancient and historical monuments; archaeological sites and remains.

16. Census.

17. Admission into, and emigration and expulsion from, India, including in relation thereto the regulation of the movements in India of persons who are not British subjects domiciled in India, subjects of any Federated State, or British subjects domiciled in the United Kingdom; pilgrimages to places beyond India.

18. Port quarantine; seamen's and marine hospitals, and hospitals connected with port quarantine.

19. Import and export across customs frontiers as defined by the Federal Government.

20. Federal railways, the regulation of all railways other than minor railways in respect of safety, maximum and minimum rates and fares, station and service terminal charges, interchange of traffic and the responsibility of railway administrations as carriers of goods and passengers; the regulation of minor railways in respect of safety and the responsibility of the administrations of such railways as carriers of goods and passengers.

21. Maritime shipping and navigation, including shipping and navigation on tidal waters; Admiralty jurisdiction.

22. Major ports, that is to say, the declaration and delimitation of such ports, and the constitution and powers of Port Authorities therein.

23. Fishing and fisheries beyond territorial waters.

24. Aircraft and air navigation; the provision of aerodromes; regulation and organization of air traffic and of aerodromes.

25. Lighthouses, including lightships, beacons and other provision for the safety of shipping and air-craft.

26. Carriage of passengers and goods by sea or by air.

27. Copyright, inventions, designs, trademarks and merchandise marks.

28. Cheques, bills of exchange, promissory notes and other like instruments.

29. Arms; firearms; ammunition.

30. Explosives.

31. Opium, so far as regards cultivation and manufacture, or sale for export.

32. Petroleum and other liquids and substances declared by

Federal law to be dangerously inflammable, so far as regards possession, storage and transport.

33. Corporations, that is to say, the incorporation, regulation and winding-up of trading corporations, including banking, insurance and financial corporations, but not including corporations owned or controlled by a Federated State and carrying on business only within that State or co-operative societies, and of corporations, whether trading or not, with objects not confined to one unit.

34. Development of industries, where development under Federal control is declared by Federal law to be expedient in the public interest.

35. Regulation of labour and safety in mines and oilfields.

36. Regulation of mines and oilfields and mineral development to the extent to which such regulation and development under Federal control is declared by Federal law to be expedient in the public interest.

37. The law of insurance, except as respects insurance undertaken by a Federated State, and the regulation of the conduct of insurance business, except as respects business undertaken by a Federated State; Government insurance, except so far as undertaken by a Federated State, or, by virtue of any entry in the Provincial Legislative List or the Concurrent Legislative List, by a Province.

38. Banking, that is to say, the conduct of banking business by corporations other than corporations owned or controlled by a Federated State and carrying on business only within that State.

39. Extension of the powers and jurisdiction of members of a police force belonging to any part of British India to any area in another Governor's Province or Chief Commissioner's Province, but not so as to enable the police of one part to exercise powers and jurisdiction elsewhere without the consent of the Government of the Province or the Chief Commissioner, as the case may be; extension of the powers and jurisdiction of members of a police force belonging to any unit to railway areas outside that unit.

40. Elections to the Federal Legislature, subject to the provisions of this Act and of any Order in Council made thereunder.

41. The salaries of the Federal Ministers, of the President and Vice-President of the Council of State and of the Speaker and Deputy Speaker of the Federal Assembly; the salaries, allowances and privileges of the members of the Federal Legislature; and, to such extent as is expressly authorized by Part II of this Act, the punishment of persons who refuse to give evidence or produce documents before Committees of the Legislature.

42. Offences against laws with respect to any of the matters in this list.

43. Inquiries and statistics for the purposes of any of the matters in this list.

44. Duties of customs, including export duties.

45. Duties of excise on tobacco and other goods manufactured or produced in India except—

(*a*) alcoholic liquors for human consumption;

(*b*) opium, Indian hemp and other narcotic drugs and narcotics; non-narcotic drugs;

(*c*) medicinal and toilet preparations containing alcohol, or any substance included in sub-paragraph (*b*) of this entry.

46. Corporation tax.

47. Salt.

48. State lotteries.

49. Naturalization.

50. Migration within India from or into a Governor's Province or a Chief Commissioner's Province.

51. Establishment of standards of weight.

52. Ranchi European Mental Hospital.

53. Jurisdiction and powers of all courts, except the Federal Court, with respect to any of the matters in this list and, to such extent as is expressly authorized by Part IX of this Act, the enlargement of the appellate jurisdiction of the Federal Court, and the conferring thereon of supplemental powers.

54. Taxes on income other than agricultural income.

55. Taxes on the capital value of the assets, exclusive of agricultural land, of individuals and companies; taxes on the capital of companies.

56. Duties in respect of succession to property other than agricultural land.

57. The rates of stamp duty in respect of bills of exchange, cheques, promissory notes, bills of lading, letters of credit, policies of insurance, proxies and receipts.

58. Terminal taxes on goods or passengers carried by railway or air; taxes on railway fares and freights.

59. Fees in respect of any of the matters in this list, but not including fees taken in any Court.

II. PROVINCIAL LEGISLATIVE LIST

1. Public order (but not including the use of His Majesty's naval, military or air forces in aid of the civil power); the administration of justice; constitution and organization of all courts, except the Federal Court, and fees taken therein; preventive detention for reasons connected with the maintenance of public order; persons subjected to such detention.

2. Jurisdiction and powers of all courts except the Federal Court, with respect to any of the matters in this list; procedure in Rent and Revenue Courts.

3. Police, including railway and village police.

4. Prisons, reformatories, Borstal institutions and other institutions of a like nature, and persons detained therein; arrangements with other units for the use of prisons and other institutions.

5. Public debt of the Province.

6. Provincial Public Services and Provincial Public Service Commissions.

7. Provincial pensions, that is to say, pensions payable by the Province or out of Provincial revenues.

8. Works, lands and buildings vested in or in the possession of His Majesty for the purposes of the Province.

9. Compulsory acquisition of land.

10. Libraries, museums and other similar institutions controlled or financed by the Province.

11. Elections to the Provincial Legislature, subject to the provisions of this Act and of any Order in Council made thereunder.

12. The salaries of the Provincial Ministers, of the Speaker and Deputy Speaker of the Legislative Assembly, and, if there is a Legislative Council, of the President and Deputy President thereof; the salaries, allowances and privileges of the members of the Provincial Legislature; and, to such extent as is expressly authorized by Part III of this Act, the punishment of persons who refuse to give evidence or produce documents before Committees of the Provincial Legislature.

13. Local government, that is to say, the constitution and powers of municipal corporations, improvement trusts, district boards, mining settlement authorities and other local authorities for the purpose of local self-government or village administration.

14. Public health and sanitation; hospitals and dispensaries; registration of births and deaths.

15. Pilgrimages, other than pilgrimages to places beyond India.

16. Burials and burial grounds.

17. Education.

18. Communications, that is to say, roads, bridges, ferries, and other means of communication not specified in List I; minor railways subject to the provisions of List I with respect to such railways; municipal tramways; ropeways; inland waterways and traffic thereon subject to the provisions of List III with regard to such waterways; ports, subject to the provisions in List I with regard to major ports; vehicles other than mechanically propelled vehicles.

19. Water, that is to say, water supplies, irrigation and canal, drainage and embankments, water storage and water power.

20. Agriculture, including agricultural education and research, protection against pests and prevention of plant diseases; improvement of stock and prevention of animal diseases; veterinary training and practice; pounds and the prevention of cattle trespass.

21. Land, that is to say, rights in or over land, land tenures, including the relation of landlord and tenant, and the collection of rents; transfer, alienation and devolution of agricultural land; land improvement and agricultural loans; colonization; Courts of Wards; encumbered and attached estates; treasure trove.

22. Forests.

23. Regulation of mines and oilfields and mineral development subject to the provisions of List I with respect to regulation and development under Federal control.

24. Fisheries.

25. Protection of wild birds and wild animals.

26. Gas and gasworks.

27. Trade and commerce within the Province; markets and fairs; moneylending and moneylenders.

28. Inns and innkeepers.

29. Production, supply and distribution of goods; development of industries, subject to the provisions in List I with respect to the development of certain industries under Federal control.

30. Adulteration of foodstuffs and other goods; weights and measures.

31. Intoxicating liquors and narcotic drugs, that is to say, the production, manufacture, possession, transport, purchase and sale of intoxicating liquors, opium and other narcotic drugs, but subject, as respects opium, to the provisions of List I and, as respects poisons and dangerous drugs, to the provision of List III.

32. Relief to the poor; unemployment.

33. The incorporation, regulation, and winding-up of corporations other than corporations specified in List I: unincorporated trading; literary, scientific, religious and other societies and associations; co-operative societies.

34. Charities and charitable institutions; charitable and religious endowments.

35. Theatres, dramatic performances and cinemas, but not including the sanction of cinematograph films for exhibition.

36. Betting and gambling.

37. Offences against laws with respect of any of the matters in this list.

38. Inquiries and statistics for the purpose of any of the matters in this list.

39. Land revenue, including the assessment and collection of revenue, the maintenance of land records, survey for revenue purposes and records of rights, and alienation of revenue.

40. Duties of excise on the following goods manufactured or produced in the Province and countervailing duties at the same or lower rates on similar goods manufactured or produced elsewhere in India—

(*a*) alcoholic liquors for human consumption;
(*b*) opium, Indian hemp and other narcotic drugs and narcotics; non-narcotic drugs;
(*c*) medicinal and toilet preparations containing alcohol or any substance included in sub-paragraph (*b*) of this entry.

41. Taxes on agricultural income.
42. Taxes on lands and buildings, hearths and windows.
43. Duties in respect of succession to agricultural land.
44. Taxes on mineral rights, subject to any limitations imposed by any Act of the Federal Legislature relating to mineral development.
45. Capitation taxes.
46. Taxes on professions, trades, callings and employments.
47. Taxes on animals and boats.
48. Taxes on the sale of goods and on advertisements.
49. Cesses on the entry of goods into a local area for consumption, use or sale therein.
50. Taxes on luxuries, including taxes on entertainments, amusements, betting and gambling.
51. The rates of stamp duty in respect of documents other than those specified in the provisions of List I with regard to rates of stamp duty.
52. Dues on passengers and goods carried on inland waterways.
53. Tolls.
54. Fees in respect of any of the matters in this List, but not including fees taken in any Court.

III. CONCURRENT LEGISLATIVE LIST

PART I

1. Criminal law, including all matters included in the Indian Penal Code at the date of the passing of this Act, but excluding offences against laws with respect to any of the matters specified in List I or List II and excluding the use of His Majesty's naval, military and air forces in aid of the civil power.
2. Criminal Procedure, including all matters included in the Code of Criminal Procedure at the date of the passing of this Act.
3. Removal of prisoners and accused persons from one unit to another unit.
4. Civil Procedure, including the law of Limitation and all matters included in the Code of Civil Procedure at the date of the passing of this Act; the recovery in a Governor's Province or a Chief Commissioner's Province of claims in respect of taxes and other public demands, including arrears of land revenue and sums recoverable as such, arising outside that Province.
5. Evidence and oaths; recognition of laws, public acts and records and judicial proceedings.

6. Marriage and divorce; infants and minors; adoption.

7. Wills, intestacy, and succession, save as regards agricultural land.

8. Transfer of property other than agricultural land; registration of deeds and documents.

9. Trusts and trustees.

10. Contracts, including partnership, agency, contracts of carriage, and other special forms of contract, but not including contract relating to agricultural land.

11. Arbitration.

12. Bankruptcy and insolvency; administrators-general and official trustees.

13. Stamp duties other than duties or fees collected by means of judicial stamps, but not including rates of stamp duty.

14. Actionable wrongs, save in so far as included in laws with respect to any of the matters specified in List I or List II.

15. Jurisdiction and powers of all Courts, except the Federal Court, with respect to any of the matters in this List.

16. Legal, medical and other professions.

17. Newspapers, books and printing presses.

18. Lunacy and mental deficiency, including places for the reception or treatment of lunatics and mental deficients.

19. Poisons and dangerous drugs.

20. Mechanically propelled vehicles.

21. Boilers.

22. Prevention of cruelty to animals.

23. European vagrancy; criminal tribes.

24. Inquiries and statistics for the purpose of any of the matters in this Part of this List.

25. Fees in respect of any of the matters in this Part of this List, but not including fees taken in any Court.

PART II

26. Factories.

27. Welfare of labour; conditions of labour; provident funds; employers' liability and workmen's compensation; health insurance, including invalidity pensions; old age pensions.

28. Unemployment insurance.

29. Trade unions; industrial and labour disputes.

30. The prevention of the extension from one unit to another of infectious or contagious diseases or pests affecting men, animals or plants.

31. Electricity.

32. Shipping and navigation on inland waterways as regards mechanically propelled vessels, and the rule of the road on such waterways; carriage of passengers and goods on inland waterways.

33. The sanctioning of cinematograph films for exhibition.

34. Persons subjected to preventive detention under Federal authority.

35. Inquiries and statistics for the purpose of any of the matters in this Part of this List.

36. Fees in respect of any of the matters in this Part of this List, but not including fees taken in any Court.

BIBLIOGRAPHY

1. Books and Works of Reference

ADARKAR, P. B. ... *The Principles and Problems of Federal Finance*, 1933.

AMBEDKAR, B. R. ... *The Evolution of Provincial Finance in British India*, 1925.

ANSTEY, VERA ... *The Economic Development of India.* 3rd edition, 1936.

APPADORAI, A. ... *Dyarchy in Practice*, 1937.

BADEN-POWELL, B. H. ... *Land Revenue in British India*, 1913.

BANERJEE, P. ... *Provincial Finance in India*, 1929.

BASTABLE, C. F. ... *Public Finance*, 1903.

BENHAM, F. C. ... *The Prosperity of Australia*, 1930.
Economics, 1938.

BENTHAM, JEREMY ... *County Courts—A Protest Against Law Taxes.* London, 1853.

BLUNT, SIR EDWARD ... *The I.C.S.*, 1937.
Social Services in India. (Editor), 1939

CANNAN, EDWIN ... *History of Local Rates in England*, 1912.

CATLIN, GEORGE EDWARD GORDON ... *Liquor Control*, 1931.

CHAND, GYAN ... *The Essentials of Federal Finance*, 1929.
The Financial System of India, 1926.

DALTON, HUGH ... *Public Finance*, 1936.
Unbalanced Budgets. (Editor), 1934.

DARLING, M. L. ... *The Punjab Peasant in Prosperity and Debt*, 1932.

DE VITI, ANTONIO, DE MARCO ... ... *First Principles of Public Finance*, 1936.

FINER, HERMANN ... *English Local Government*, 1933.

GANGULEE, G. N. ... *The Making of Federal India*, 1936.

GRICE, JAMES WATSON ... *National and Local Finance*, 1910.

HICKS, U. K. ... *The Finance of British Government*, 1938.

HILTON-YOUNG, E. ... *The System of National Finance*, 1936.

HOBSON, J. A.... ... *Taxation in the New State*, 1919.

HOWARD, A. ... ... *Crop Production in India*, 1924.

KNOWLES, L. C. A.	*Economic Development of the Overseas Empire*, 1928.
LUTZ, H. L.	*Public Finance*, 1936.
MACDONALD, J. RAMSAY.	*The Government of India*, 1930.
MARSHALL, ALFRED .	*Nation Taxation after the War.* This forms chapter xviii in *After War Problems*, Edited by William Harbutt Dawson, 1917.
MILL, JOHN STUART	*Principles of Political Economy.*
MUKERJEE, R.	*Land Problems in India*, 1933.
	Rural Economy of India, 1926.
MULLA, D. F.	*Principles of Hindu Law*, 1936.
PIGOU, A. C.	*The Economics of Welfare*, 1929.
	A Study of Public Finance, 1929.
SELIGMAN, E. R. A.	*Essays in Taxation*, 1925.
	Studies in Public Finance, 1925.
	Progressive Taxation in Theory and Practice, 1908.
SHAH, K. T. ...	*Sixty Years of Indian Finance*, 1921.
SHAH, K. T. AND KHAMBATTA, K. J. ...	*Wealth and Taxable Capacity of India*, 1924.
SHIRRAS, G. FINDLAY ...	*Science of Public Finance*, 2 vols., 1936.
SMITH, ADAM ...	*The Wealth of Nations.* Cannan's edition, 1930.
STAMP, LORD ...	*The Fundamental Principles of Taxation*, 1936.
	Wealth and Taxable Capacity, 1922.
STRACHEY, SIR JOHN AND LT.-GEN. RICHARD ...	*The Finances and Public Works of India*, 1882.
VAKIL, C. N. ...	*Financial Development in Modern India*, 1924.
WARBURTON, CLARK ...	*The Economic Results of Prohibition*, 1932.
WEBB, SIDNEY ...	*Grants-in-Aid*, 1920.
WESTLAND, SIR JAMES ...	*The Indian Stamp Act (II of 1899)*, 1899.
WUORINEN, J. H. ...	*The Prohibition Experiment in Finland*, 1931.

2. OFFICIAL AND OTHER PUBLICATIONS

1. *Administration Reports of the United Provinces* (Annual), 1921–2 and subsequent years.
2. *Census of India, 1931*; *Census of the United Provinces, 1931.*

3. *Calcutta Review, 1845*, vol. iii.
4. *Devolution Rules.* Cmd. 891 (1920).
5. *Financial Statements, 1860–61; 1861–62.*
6. *Finance Bills of the Government of India*, 1921–2, and subsequent years (with Budget Debates).
7. *Indian Statutory* (Simon) *Commission.* 2 vols.: vol. i, Cmd. 3568, vol. ii, Cmd. 3569.
8. *Indian Statutory Commission*, vol. ix; *Memorandum submitted by the United Provinces Government* (1930).
9. *Indian Taxation Enquiry Committee Report* (1924–5).
10. *Indian Year Book*, 1920 and subsequent years.
11. *Moral and Material Progress of India.* Annual Reports, 1921–2 and subsequent years.
12. *Proceedings of the Legislative Assembly*—Budget Session (1921–37).
13. *Proceedings of the United Provinces Legislative Council* (1921–37).
14. *Report of the* (Inchcape) *Retrenchment Committee* (1922–3).
15. *Report of the Royal Commission upon Decentralization in India.* Cmd. 4360 (1908).
16. *Report on Financial Relations* (Meston Report). Cmd. 724 (1920).
17. *Report of the Joint Committee on Indian Reforms* (1933–4), vol. i. part I.
18. *Report of the Reforms Enquiry Committee*: (1) Cmd. 2360; (2) Cmd. 2361; (3) Cmd. 2362 (1925).
19. *Report of the Provincial Governments on the Meston Committee.* Cmd. 974 (1920).
20. *Report of the United Provinces Banking Enquiry Committee* (1929–30), vol. i.
21. *Report of the Royal Commission on Local Taxation.* Cmd. 638 (1901) (English).
22. *Report of the United Provinces Agricultural Debt Enquiry Committee, U.P. Gazetteer*, September 10, 1932.
23. *Report on the Working of Municipalities in the United Provinces*, 1921 and subsequent years.
24. *Report on the Working of the District Boards in the United Provinces*, 1921 and subsequent years.
25. *Reports on the Working of Municipalities in Bombay, Madras, Bengal and the Punjab* (several years).
26. *Report of the Indian Irrigation Commission (1901–3).* Cmd. 1951 (1903).
27. *Report of the Indian Famine Commission.* Cmd. 2735 (1880).
28. *Report of the Committee on National Debt and Taxation* (Colwyn Committee). Cmd. 2800 (1927).

29. *Report of the Director of Public Health, United Provinces* (Annual).
30. *Report of the Director of Agriculture, United Provinces* (Annual).
31. *Report on Public Instruction in the United Provinces* (Quinquennial), 1937.
32. *Report on the Working of the Stamps Department, Madras, Bombay, Bengal, Punjab, United Provinces* (several years).
33. *Report on Forest Administration* (Annual). Government of India and the United Provinces.
34. *Report on the Excise (Intoxicating) Administration.* Government of India (Annual).
35. *Report on the Triennial Review of Irrigation* (1933–6).
36. *A Scheme for an Economic Census of India*, by A. L. Bowley and D. H. Robertson (1934).
37. *Report on Indian Constitutional Reforms.* Cmd. 9109 (1918).
38. *Report of the Welby Commission* (4 vols). Cmds. 130 and 131 (1900).
39. *Report of the Accountant-General, United Provinces*, 1921–2 and subsequent years.
40. *Report of the Hartog Committee (Education).* Cmd. 3407 (1929).
41. *Resolution of the Government of India on Land Revenue.* Cmd. 1089 (1902).
42. *Statistical Abstract for British India.*
    (1) Cmd. 3291 (1928)
    (2) Cmd. 5804 (1938).

ACTS

The Bengal Amusement Act (V) of 1922.
The Bombay Betting Act (VII) of 1922.
The Bombay Entertainments Duty Act (V) of 1923.
The Commonwealth of Australia; The Estate Duty Assessment Act (1916–18).
The Government of India Act, 1919.
The Government of India Act, 1935.

JOURNALS

The Indian Journal of Economics.
The Economic Journal.
The National Municipal Review.
Hansard, vol. cxxvii, 1853.

INDEX

Ability, theory of taxation, 33, 35, 303-5
— assets as a test of, 321, 322
— expenditure as a test of, 322-4
— income as a test of, 320, 321
— special ability as a test of, 320, 324, 325
Adarkar, B.P., 24
Adequacy, principle of, 24, 26, 28, 30, 55
Agricultural Commission, 13
Agricultural Debt Enquiry Committee Report, 149 *n.*
Agricultural incomes, taxation of —*see* Taxation
Agricultural marketing, 245, 246
Agriculture, 2, 13, 242, 243, 245, 297, 300, 301
Agriculture Department, 243 ff.
Aligarh Muslim University, 233
Allan, R.G., 14
Allocation of resources, 9, 16, 21, 24–6, 28
— of revenue, 112–14
Ambedkar, B.R., 40
Anstey, Vera, 1, 2, 3, 8, 89, 93, 110, 145, 150, 160, 163, 178, 179, 215, 216, 220, 221, 234, 235, 242, 246, 269, 270, 296, 298, 300, 301
Appadorai, A., 60, 136
Arrested economic development, 1, 2, 235
Assignments—*see* Budgets
Average density, 8
Autonomy, provincial—*see* Provincial

Baden-Powell, B.H., 145
Balanced economic system, 246–8, 300
Balancing factors, 24, 30
Balfour, Lord, 287, 289, 290
Banerjee, P., 38, 42
Banking Enquiry Committee, Report of, 13, 150
Barker, Sir Edward, 281
Bastable, C.F., 214
Benares Hindu University, 233
Beneficial services, 31, 32, 34—*see* Onerous
Benefit theory, 32, 33, 303, 304
Benham, F., 26, 27, 167, 203, 309–15, 317, 325, 326
Bentham, Jeremy, 199, 200
Birth rate, 235
Blackett, Sir B., 87, 88 *n.*, 89 *n.*, 90, 92 *n.*
Blunt, Sir E., 10, 11, 139, 146
Borrowing, provincial—*see* Provincial
— rules, 78
British rule, effects of, 4
Budgets, 10, 11, 24, 40, 42, 48, 56, 80, 84, 85, 253–5
— by assignments, 44–6, 56
Burden of taxation, 215–21
Bureaucracy, alien, 20
Butler Committee, 111

Calvert, H., 244
Cannan, E., 20 *n.*, 32, 33, 34 *n.*, 273, 291 *n.*, 325
Catlin, G.E.C., 180
Census of India, 5, 7–9
Central subjects, 59
Centralized system of finance, 37, 40, 56
Charter Act (1833), 37
Chelmsford, Lady, 240
Chelmsford, Lord—*see* Montagu and Reforms
Chitnavis, S.M., 83 *n.*
Civil List, King's, 27, 139
Civil Service, 19 *n.*
Clark, Warburton, 180 *n.*
Colwyn Committee Report, 216, 221
Commercial monopolies, 23
Commissioners' Provinces, 5
Commonwealth of Australia Estate Assessment Act, 210, 211
Concurrent Legislative List, 107, 108, 335–7
Congress, 19 *n.*, 188 ff., 191, 246, 251, 252, 258
Congress prohibition programme, 188, 189, 251—*see* Excise
Constitutional basis, 58, 107
Contributions, 23, 28, 43, 65–76, 88–90, 95–102, 111
— initial, 71, 72
— standard, 72–5
Co-operative societies, 17, 297
Countess of Dufferin Fund, 239

Cornwallis, Lord, 157
Corporations, 54, 272, 293
Corporation tax, 24, 30, 114–24
Costs principle, 26
Country spirit, consumption, 186
— shops, 183–5
— taxation, 182
Court fees, 199, 200, 205
Curzon, Lord, 18, 56 *n.*, 161, 162, 295
Customs, 11, 45, 54, 94, 100–103, 111, 219

Dalton, H., 178, 217
Darling, Sir M.L., 1
Davidson Committee, 111, 112 *n.*
Dayabhaga law, 208, 209
Death duties, 24, 30, 158, 193, 201–11, 269, 299
— best method of taxing, 209–11
— equity of 201–3
— objections to, 203
— types of, 203–5
Death rate, 235
Debt, 12, 27, 40, 41, 54, 292–4
Debt cancellation, 125, 126
Decentralization Commission, 39 *n.*, 49, 272
Decentralization of balances, 125, 126
Deficit provinces, 124–6
Deficits, 23, 40, 41, 50, 52, 53, 65, 87, 88
Demand for grants, 143
Depression, 18, 269, 270—*see* also Economic Depression
De Viti de Marco, A., 27, 162, 167, 168, 175, 176, 194, 195, 307, 308, 311, 318
Devolution Rules, 75, 76, 84, 108 *n.*
Devolved authority, 108
Direct taxation, 24, 319, 320
Discriminating price, 26, 27
Distress gold, export of, 270
Distribution of legislative powers, 107, 108—*see* also Federal, Provincial, and Concurrent
District Boards, 273–5, 277, 281, 282—*see* Municipalities and Local finance
Divided heads—*see* Revenue
Doles, 28, 43
Draft orders, 130
Dunn, Lt.-Col. C.L., 240, 241
Dufferin—*see* Countess of Dufferin
Dyarchy, defects of, 85, 86
— working of, 61, 82–4, 143

East India Company, 55, 161, 272, 295
Economic conditions, diversity of, 3
— depression, effects of, 263, 296
— outlook, absence of, 2
— progress, obstacles to, 2
Economy Committee, 259
Edgeworth, F.Y., 305
Education, 27, 47
— among boys, 228, 231, 232
— among girls, 228, 231, 232
Employment tax, 188–90
English Estate Duty, 209–11
Entertainment tax, 211–13
Entrepreneur, 27
Epidemics, 235, 236
Equilibrium approach in public finance, 307–11
Excise, 24, 25, 29, 30, 42, 44, 102, 103, 113, 179–88
— American experience, 180–2
— policy of Provincial Governments, 182–5—*see* also Congress prohibition programme
— revenue from, 186–8, 266, 268
Excise duty on kerosene, 217, 220
— — matches, 217, 220
— — motor spirit, 220
— — sugar, 217
Expenditure, military, 19
— provincial, 222 ff.
— public, 16, 20, 21, 27
Export duty, 30, 114, 217

Famine, 10
— Code, 10
— Commission (1880), 166
— Relief Fund, 10, 11, 48, 164, 247–9, 254
Federal Constitution, 44
— Legislative List, 107, 108, 329–32
— subsidies, 23
Federating Authorities, 21
Federation, 21, 22, 24, 107, 111
Fee, 29, 63, 167, 168, 284
Fees and licenses, 284, 285
Finance Department, criticism of, 136, 137
— — functions of, 133, 134
— — position of, 134, 135
Financial administration (1919), 132 ff.
— (1937), 141–3
— centralized system, 37, 40
— decentralized system, 41, 42, 56
— — advantages of, 42
— — defects of, 43
— — objects of, 42
— — Reforms, 44
— devolution, 56

Financial reforms, conditions of, 18
— — lines of, 19
— Relations Committee, 68—*see* also Meston Committee
— Resolution, 41
Finer, H., 288, 289
Finland, prohibition experiment in, 182 *n.*
Fiscal system, 10
Fixed costs, principle of, 34, 35
Forests, 45, 86, 173–9, 266, 268, 269
— area under, 173
— control of, 174, 175
— finance, 175, 176
— Indian policy, 176, 177
— revenue and expenditure, 177, 178
French Revolution, 162
Fund, Famine Relief, *see* Famine

Gangulee, N., 85
General public services, 309—*see* Special services
Ghaznavi, A.K., 61
Gladstone, W.E., 318
Gokhale, G.K., 43, 95
Government of India Act (1919)—*see* Central and Provincial Subjects
— (1935), 107, 112 *n.*, 122, 190
Governors' Provinces, 4
Grants-in-aid, 31, 32, 51, 111, 285, 286
— advantages of, 286–8
— need for, 285, 286
— need in India, 289
— principles of, 289–91
— theory of, 32
Grice, J.W., 291 *n.*, 292 *n.*, 293 *n.*
Guillebaud, C.W., 325 *n.*
Gyan Chand, 43, 47

Hailey, Lord, 87, 88 *n.*, 126
Hansard, 201
Hardinge, Lord, 53
Har Kishan Lal, Lala, 83 *n.*
Hemp drugs, 187, 188—*see* Excise
Hicks, Mrs U.K., 138, 222 *n.*, 250, 316
Hilton Young, E., 132 *n.*, 135 *n.*
Hobson, J.A., 196
Holdings, definition, 14
— economic, 14, 149, 150
— size of, 13
Home Charges, 47, 48
Howard, Sir A., 177
Hydro-electric grid scheme, 297
Hydro-electric power, 11 *n.*, 297

Illegal exactions, 151
Imperial Council of Agricultural Research, 243
Imperial deficits, 41
Import duty, 217, 220
Inchcape Retrenchment Committee, 19 *n.*
Incidence of taxation, 18, 45, 215–21
Incomes, inequality of, 313–15
— *per capita*, 18
Income-tax, 11, 29, 30, 100–103, 111, 114–24, 128, 129, 217, 219, 269, 300, 325
— and savings, 325–7
India Councils Act (1861), 40
Indian Finance Act, 179 *n.*
Indian States, 5, 21 *n.*, 23—*see* Butler and Davidson Committees
Indirect tax, 23, 25, 217—*see* Direct tax
Industries, geographical distribution of, 15
— large-scale and small-scale, 15, 16, 246–7
Inequality of incomes, 25, 314—*see* Incomes
Infant mortality, 240
Initial contributions, 71—*see* Contributions
Insurance, National Health, 248, 249
— Unemployment, 250, 251
Inter-provincial inequalities, 24, 25, 99–103
Iron and steel industry, 15
Irrigation, 10, 11, 12, 14, 29, 45, 77, 78, 112, 164–73, 297
— charges, 169, 170
— Commission (1901), 170
— finance, 165–9
— revenue from, 165, 266, 268, 269
— under Reforms (1919), 164

Jack, J.C., 151, 156
Jevons, Stanley, 15
Joint Budget, working of the—*see* Budgets
— Committee (1933–4), 107–9, 112 *n.*, 121
— or separate purse, principle of the, 84, 85, 135—*see* Purse
— responsibility, principle of, 61, 82–4
— Select Committee (1919), 58, 68, 71, 84, 100
Justice—*see* Law and Justice

Jute export duty, 126–30, 217, 220
— industry, 15

Keatinge, G.F., 14, 15
Kelkar, Rao Bahadur, 83 *n.*
Khambhatta, K.J., 18
King's Civil List, 27, 139
Kisch, Sir Cecil, 21, 22 *n.*
Knowles, L.C.A., 166

Laing, Samuel, 41 *n.*
Land Revenue, 4, 11, 13, 14, 20, 28–30, 44–6, 48, 102, 103, 112, 144, 217, 219, 242, 265, 266, 270, 296, 297, 299
— defects, 146, 147
— illegal exactions, 151, 152
— income from, 154
— progression in, 148, 149
Land tenures, 28
Law and justice, 44, 47
Layton, Sir Walter, 18
Legislation, agrarian, 17
— Central, 29
Legislative Lists, 107, 108, 329–37
License tax, 45
Limited responsible government, 58, 59
Local finance, 19, 31, 33–5
— indebtedness, 292–4
— rate, 281
— Self-Government, 41, 59, 61–3, 237–9, 299, 301
— services, 32, 33
— — beneficial, 33
— — financing, 33
— — onerous, 33
— taxation, 34–6, 42, 271 ff.—*see* Taxes on land and buildings, persons, property and trades
Local Taxation, Royal Commission (1901), 32
Lutz, H.L., 179, 180, 181, 214, 274
Lytton, Lord, 44

Macdonald, J. Ramsay, 85 *n.* 169 *n.*
Mackenzie, Sir A., 46
Maine, Sir Henry, 199
Malthus, 2
Manifold tax system, 21, 319, 320
Mann, H., 14 *n.*
Marginal costs, 34, 35
Marshall, Alfred, 314
Mayo, Lord, 41, 42, 44
Medical Department, 238
Medicine, indigenous systems, 238, 239
Meston Award, 69, 70
Meston Committee, 69 ff., 82, 99 *n.*, 101
Meston, Lord, 68, 82 ff.
Meston Settlement, 36, 82, 87 ff., 97–103, 106, 130
Mill, John Stuart, 196, 199, 200, 305, 319
Minimum income, 315
— sacrifice, principle of, 305–7
Minorities, 26, 27
Misra, B.R., 13, 151, 158
Mitter, Sir P.C., 83 *n.*
Mitakshara law, 208, 209
Monopoly, 23, 26
Monsoon, 10, 11
Montagu-Chelmsford Reforms, 17, 36, 58 ff., 65, 98, 103, 107, 123
Muddiman Committee, 83, 85, 86, 94
Mukerjee, R., 151, 156, 177
Mulla, D.F., 208
Municipality, 34, 62, 63, 279–81
— income of, 276—*see* District Board
Mutiny, 55

National finance, 33
— minimum, 25, 26, 31
— — income, 315, 316
National Municipal Review, 181
National services, 31
Neutral tax system, 309–12
Niemeyer (Sir Otto) Report, 112 *n.*, 117, 121–4, 127–31, 190

Occupational distribution, 9
Octroi, 63, 277–9
O'Donnell, Sir S.P., 172
Onerous services, 31, 32, 35—*see* Beneficial
Opium, 45, 47, 113, 114—*see* Excise
Opportunity cost, 27
Optimum population, 8—*see* Population
Over-population, 1, 8

Panchayats, 62, 272
Peel Committee (First), 111, 112 *n.*, 115
Peel Committee (Second), 119, 120
Percy Committee, 112 *n.*, 115 18, 126, 130
Permanent settlement, 97, 153–7, 160
Petrol tax, 188, 190—*see* Tax on motor spirit
Physiocrats, 317
Plantation, 15

Pigou, A.C., 201, 305, 306, 315, 322–6
Poor relief, 26, 27
Population, 1, 3, 8–10, 17, 25, 30, 298
— average density, 8
— optimum, 8
— pressure of, 1, 8
— unequal distribution of, 8
Post and telegraphs, 29, 45, 47, 114
Port Trusts, 54
Poverty, 1, 13, 19 *n.*
— causes of, 241
Preferred expenditures, 27
Principle of ability, 20
— of adequacy, 24, 26, 28, 30, 55
— of equality, 20
— of service, 34
Probate duties, 205–8—*see* Death duties
— — law on, 206, 207
— — rate and yield, 205, 206
Progress, possible lines of, 299
Progressive tax system, 325, 328—*see* Best tax scheme
Prohibition, 180—*see* Excise and Congress
Property, Federal, 23
Provinces, area, 5
— Commissioners', 5
— Governors', 4
— population, 5
Provincial autonomy, 3, 4, 36, 64, 106–10
— — essence of, 108, 109
— — financial procedure under, 141
— — main features of, 109, 110
— — safeguards, 109, 110
— borrowing, 78, 79
— budgets—*see* Budgets
— contributions—*see* Contributions
— economic nationalism, 4
— expenditure, 222 ff., 255–65
— — on agriculture, 226
— — on development departments, 228 ff.
— — on education, 228 ff.
— — — on primary, 230–2
— — — secondary, 232, 233
— — — university, 233, 234
— — on industries, 226
— — on jails and convict settlements, 224
— — on justice, 224
— — on law and order, 222–5
— — on medical relief, 226, 234–42
Provincial expenditure on police, 224
— — on public health, 226, 234–42
— finance, 12, 19, 28, 36, 37, 43, 47
— Legislative Lists, 107, 108, 190, 332–5
— Loan Account, 77
— rate on urban areas, 188, 191
— revenue, 92–5, 255–69
— — excise, 266
— — forests, 266
— — irrigation, 266
— — land revenue, 266
— — stamps, 266
— subjects, 59, 108
Public Accounts Committee, 132, 140
— debt, 54
— expenditure, 20, 27
— finance, 13, 42
— health, 27, 234 ff., 297
— — services, 234 ff.
— service, general, 26
— — special, 26—*see* Social Services
— utility, 26
— Works Department, 55
Purchasing power, 11
Purse, joint or separate, 84, 134, 135—*see* Joint budget

Quasi-permanent settlement, 47
Quinquennial settlements, 46—*see* Settlements

Railways, 22, 24, 26, 29, 45, 114
Rao, V.K.R.V., 18
Rate, 29, 32, 45
— water, 32
Reading, Lord, 81, 89
Reforms of 1919, 3, 4 *n.*, 37, 46, 53, 57–9
Reformed Councils, 69
Reforms Enquiry Committee—*see* Muddiman Committee
Registration fee, 45, 47, 113, 193–9, 219, 221
Remissions, 11
Reserved subjects, 59, 82–4, 108 *n.*, 109, 135, 136
Responsible government, 19
Retrenchment, 19
Revenue, 12, 16, 18, 26, 28, 38, 47
— assigned to Federation, 113, 114
— assigned to States, 114
— concurrent, 113, 114
— divided heads of, 45, 46, 47, 49, 64

Revenue, imperial, 45, 48, 49, 65
— inelastic, 30
— provincial, 3, 45, 49, 65, 255 ff.
— sources of, 23, 104
— stagnation of, 265
Ross, A., 38 *n.*
Rotation of crops, 1
Round Table Conferences, 107 ff.
Ryot, 15, 17

Safeguards, 27, 109
Sales tax, 188, 190, 191
Salt tax, 29, 45, 88, 89, 114, 127, 219, 220
Sapru, Sir Tej Bahadur, 233
Sarda canal, 260, 262, 263, 268, 297
Scheduled taxes, 63, 79, 80, 211–15, 219, 221
Secondary education, 232, 233
Seligman, Edwin, 23, 95, 147, 303
Settlements, advantages, 49
— financial, 25, 37, 43–6
— quinquennial, 45, 46
— quasi-permanent, 47 ff., 53, 56
— permanent (1912), 49, 53, 56
Shah, K.T., 18, 165
Shared revenues, 28
Shirras, Findlay, 18, 213, 214
Sidgwick, H., 305
Simon, Sir John—*see* Statutory Commission
Single tax, 317, 318
Slater, G., 246
Small-scale industries, 245
Smith, Adam, 193, 195, 196, 199, 202, 304
Social services, 17, 297
— — obstacles to the development of, 297–301
Special ability principle, 21
— claims, 16
— and general public services, 309–11
Stamp duties, guide to, 197
— — income from, 198, 199, 266, 268
— — objections to, 195–7
— — theoretical arguments, 193, 194
Stamp, Lord, 21, 213, 278, 303, 307, 318, 320, 325, 326
— contributions, 72—*see* Contributions
Stamps, 29, 44, 45, 103, 113, 114, 219, 221
— commercial 29
— general, 29
— judicial, 29
Standard of comfort, 14
— of life, 18, 19
Standing Finance Committee, 132, 139
States, 5, 21 *n.*, 23, 24—*see* Indian States
State policy, 241
Statutory (Simon) Commission, 8, 9, 62, 102, 107, 235, 237
Strachey, General Richard, 38, 39
— Sir John, 38, 44
Studenski, P., 181
Subjects—*see* Central, Provincial, Reserved, and Transferred
Subsidy, 35
— federal, 23
Subventions, 25, 26, 128, 129
Sukkur Barrage, 110 *n.*, 124, 297
Super-tax, 30
Supreme Government, 38
Surcharge, 30
Survey, 13
Suspensions, 11
Swarajists, 61 *n.*, 86

Taussig, F.W., 33
Tax, 21, 29, 33, 63
— direct, 24, 217, 319, 320
— federal, 23
— indirect, 23, 25, 217
— *in personam*, 147, 162
— *in rem*, 146, 147, 162
— progressive, 21
— regressive, 21
Taxation, 18, 21—*see* Ability
— best scheme of, 312, 313
— burden of, 18
— canons of, 303 ff.
— Enquiry Committee, 145–7, 149, 157, 165, 167, 170, 171, 174, 192 *n.*, 197, 207, 208, 211, 273, 278, 282, 289
— matter of compromise, 20, 21
— per head, 216, 218, 219
— principles of, 20, 303 ff.
— progressive distribution, 19
— theories of, 21
Taxes, capitation, 113
Taxes on agricultural incomes, 30, 113, 114, 156–60, 299
— animals and boats, 113
— betting, 193, 213–15, 221
— entertainment, 193, 211, 212, 213, 221
— goods and advertisements, 113
— land and buildings, 113
— luxuries, 113
— mineral rights, 113

Taxes on motor spirit, 217—*see* Petrol tax
— persons, 283, 284
— property, 279–83
— transfers of property, 193–5, 279
— railways, 114
— terminal, 114
— tobacco, 114
— trades, professions, and callings, 63, 190, 277–9, 284
Tenant law, abuse of, 151
Test of ability, 21—*see* Ability
Terminal taxes, 114
Toll, 63, 113
Transferences, principle of, 25
Transferred subjects, 59, 60, 61, 82–4, 108 *n.*, 109, 135, 136
Treasury Bills, 89 *n.*
Trevelyan, Sir E.J., 208
Tribute, 47
Trusts, town improvement, 260
Tube-well, 11 *n.*

United States excise policy, 180
University education, 233

Village communities, 272, 273
— *panchayats*, 272–5
Voted and non-voted items, 138, 139, 141–3

Webb, Sydney, 271, 285–5
Welby Commission, 43
White Paper, 120, 121, 127
Wilson, James, 40, 157
Wuorinen, J.H., 182