CHAPTER - 2. RESOURCE MOBILISATION BY STATES AND THE SCOPE FOR FISCAL ADJUSTMENTS.

Since either the experience in the performance of allotted tax powers and service functions of States or the logical a priori analysis should necessarily be the basis for any programme of fiscal adjustments aiming at their economic and efficient utilisation, in the context of development, physical and financial mobilisation to the optimum, validity of some views suggesting States' slackness in the financial mobilisation prevalent in academic circles and official quarters require thorough probe; hence they are examined below to explore the scope for changes in powers and functions at Macro-level. At the Micro-level inspection process consists in examining the performance of single State, according to different criteria, at the over-all level and tax and non-tax sources of revenue with a view to augment revenues besides exploring the possibility for the transfer of a tax to a higher or lower level of Govt. for efficient performance and optimum mobilisation. This has been undertaken in chapter, 4 with reference to revenue performance of Andhra Pradesh.

VIEWS ON FINANCIAL MOBILISATION BY STATES.

(A) States, it is said, are unwilling to incur the displeasure of electorate, with whom they are in closer contact than the Union Govt., by being adventurous in increasing the level of taxation for financing their developmental plans.¹

(B) Since efficiency in financial mobilisation has not been duly recognised for the purpose of grants and other financial help

¹ Refer (1) Article on "Resource mobilisation" by K.N. Raj, in "Third Five Year Plan and India's Economic growth" Ed. by B.C. Tondon, p.60-61; (2) also P.S. Lokanathan's essay "Taxation and the Plan" in the same book; (3) Prof. Raj points that Union Govt. also failed to mobilise sufficient resources. This aspect is considered in the next chapter; (4) Often Rural Sector has been pointed as the potential source of additional taxation. Vide R.B.I. Bulletin, August, 1957, p. 138; (5) Third Five Year Plan, page, 104.
From Union Govt., or through the recommendations of F.C's., it is opined that States are motivated by a desire to drive slow whereby they can neither run the risk of losing popularity nor will they mind seriously for being treated on par with those States that do really lag behind and yet derive the equal treatment from Union Govt. or F.Cs., or Planning Commission in the matter of grants to them.¹

(C) In some quarters diametrically opposite view is held. According to this view, probably, some States, if not all, have done their best, but because of the absence of standards of scientific assessment of financial resources that a State can mobilise, their performance was publicised as below their potential capacity.²

(D) States, it is said, are unwilling to exploit their own tax resources for fear of centralisation which hangs like Damocles Sword as was evident from the replacement of Sales Tax on sugar,

¹ Also there is another type of reaction by States. "In Bombay fresh tax proposals are being kept in abeyance pending the final recommendation of Finance Commission. The Finance Minister of Bombay has stated that the public of State will have to bear larger share of additional taxation proposed by Union Govt, which measured by collection would come 40%. He also referred to the fact that tax effort of the State exceeded the targets." R.B.I. Bulletin, August, 1957, p. 738.

² This view has been substantiated by the following facts, (a) It is only very recently that N.C.A.E.R. has completed the Techno-Economic surveys of different States that give some clue to the resource potential. Further those reports did not assess the taxable capacity and performance, but only made some projections of revenues based on certain assumptions. (b) F.C. (1961) pointed that tax effort can't be made in absolute terms and it has to be "related to the tax potential which calls for a special study". Hence clearly systematic and scientific study of tax potentials and efforts of States were not undertaken till 1961. (c) State income estimates were made only during the 2nd Plan period; and even these are not strictly comparable with those of other States, due to "considerable differences in estimation process". Vide "Estimates of State Incomes by P.D. Ojha, I.E.J. July-Sep. 1963, pages 2-3; also refer "Indian National and State Income data - some aspects" by Chowdry, M.D., and Bert Hoselitz, E.W. dt, 2-10-1965 and 9-10-1965. (d) Estimates of agricultural incomes of States, which account for nearly 50% of Incomes, are subject to variations due to imputed value; this aspect is relevant since agricultural sector is blamed for its lower performance; non-monetary segment of agricultural sector was significant and its quantitative estimation was not done in recent times except the one undertaken by Taxation Enquiry Commission.
tobacco and textiles by additional excise duties by Union Govt. as well as when some more articles are brought under levy.  

Further the compensation for the loss of Revenue to States, it is opined, was unfair and that if the tax was allowed to be levied by States they could have probably collected even larger amounts. In fact States were given only a share in the fixed sums collected during the years 1954-56 rather than a share in the increasing total revenues which might have otherwise benefited the States. Thus the compensation process indirectly helped an under-estimation of States financial mobilisation.

(E) In the assessment of financial mobilisation by States, Revenues collected by numerous local Govts, and other local bodies are not included which further led to an under-estimation of States performance.

(F) Finally, Planners recognised that Union Govt. has to find out finances not only for itself but also for the States, which by implication concedes the severe inherent limitation on the part of States ability to raise necessary finances and the consequential increased dependance on Union's finances. This implication, it is contended, has been overlooked while evaluating the performance of States.

1. a) Another reason for not resorting to additional taxation by some States (U.P. and West Bengal during 1958-59) is that the levy of Central Sales tax now covers transactions which were to long tax free", R.B.I. Bulletin, May, 1958, page, 508. (b) Note the comment of R.B.I. "According to Budget estimates for 1958-59 revenue from Sales tax would show a decline of Rs. 12 crs. due to levy of additional excise duties in lieu of S.T. on tobacco, textiles and sugar", R.B.I. Bulletin, May 1958, page, 506.

2. Refer "substitution of Excise tax for Sales tax" by D.R. Singh, E.W., dt. 11-6-1964, p. 1127-36.


4. a) In this study only local Govts., are considered; (b) In the year 1961-62 local Govts. collected an amount of Rs. 19.46 crs. (excluding State Govt. grants) which is equivalent to 20% of State's finances or 1.7% of A.P. States' income during that year whose omission is therefore a serious one and hence presents incorrect picture of States efforts.

It is in the context of non-assessment of taxable capacity of States, centralisation of taxation on some commodities and services, the constant threat of centralisation, the compensation process adopted, exclusion of local finances from the perivew of assessment of States performances and implicit recognition of Centre's role in resource mobilisation that the States' performances are judged and conclusions drawn. Therefore, it is evident that techniques for assessing States tax effort have not been evolved so far. In examining States performances another problem is: whether fiscal and some of the monetary operations (public borrowings) can be effectively followed by them as well as by Local Govts? If the performance of financial mobilisation by any level of Govt., in a federation has to be evaluated further problems are: what techniques have to be adopted? What assumptions are to be made? What criteria should govern the conclusions on the success or failure? and whether these suggest any scope for transfer of tax powers between Union and States or States and Local Govts., and vice versa? Whether the basic purpose of financial mobilisation for development could be served by States performance alone? etc.

TECHNIQUES FOR EVALUATING STATES TAX EFFORT.

Different Macro-techniques considered below should only be viewed from their suitability in locating States that failed in their fiscal performance and correlating the conclusions arrived therefrom for affecting fiscal adjustments. While fiscal adjustments can't be undertaken on the basis of single State performance of such of those States may further be examined together with the rest to explore the scope for fiscal adjustments through rate uniformity or outright transfer of tax powers. Briefly, those techniques are (1) per centage methods (2) per capita method (3) per capita per centage method or relative sacrifice or tax effort methods
(4) equal tax burden method (5) Quantum tax targets method.

By way of explanation of the above methods we may say that the per centage method implies that a State has adequately taxed if the per centage increase in the tax Revenue of the State was in proportion to the per centage increase in the State income during that period. Secondly, per capita method implies that if the per centage increase in per capita tax revenues or State's revenues kept pace with the per centage increases in per capita incomes during that period then that particular State's performance can be treated as satisfactory. Third method is a combination of per capita and per centage concepts. While a simple formula is suggested whereby per capita tax collected in each state is expressed as per centage of per capita income of that State, few more formulae are suggested. They are Mr. Mahadevan's concept of relative sacrifice¹ and Prof. K.V.S. Sastry's "Ideal or potential" tax effort concept.² In the former the index of sacrifice is calculated by dividing State's taxes expressed as per centage of State income with its per capita income and multiplying it with proportion of State's consumer prices and Federal prices. Prof. Sastry's index of relative or potential or ideal tax effort of any State is "the average tax efforts of all several States is in each case multiplied by the relative per capita State Income (i.e. their respective per capita incomes expressed as ratios of weighted average of the per capita incomes of all States)³.

This index was calculated both on proportionate and progressive scales. Nextly, according to equal tax burden method of Mr. A.S.Donnahoe,⁴ persons belonging to same income groups are supposed to contribute

3. Ibid page 37.  
in equal proportions towards tax revenues of their States. Different rates applied to different income groups give different quantum of equal tax burden that may be borne by that State. Finally quantum tax targets method is followed wherein targets for additional taxation are allotted to States by Planning Commission for being mobilised by States.

While all these methods can be expressed in algebraic form (which has not been done here) their limitations in assessing independent effort and other implications have to be noticed before finding fault with the performance of different States. (A) Even though the commonsense understanding of first three methods suggest that their frequent application is due to their ease in calculations, they do not satisfy the qualification of 'independent effort'; but they cannot be totally relied upon, in the Indian context since (a) State incomes have yet to be placed on scientific and comparable basis. (b) As independent tax effort has to be assessed, State incomes estimated on the basis of 'origin' rather than on accrual basis (which includes net income resulting from inter-state trade that has to be deleted), should form the basis of such assessment. (c) Prevalence of significant non-monetary sector in State incomes hinders the operations of Tax State. (d) Per capita assessment should give place to more meaningful index like economically active population since adding unemployed with gainfully employed, in a country with large army of under and unemployed manpower, is unfair. Mahadevan's and Sastry's methods while they do not assess

State's independent effort, have the following limitations. Mahadevan's Index of equal sacrifice is nothing but a modification of Frankel's index multiplied by consumer price relatives of States with that of Union's price relatives. In the Indian context States consumer prices are subject to artificial pressures of zonal systems which distort real price situation, hence its application presents unrealistic picture of State's effort. While the above remarks relating to State incomes and per capita concepts equally apply to Prof. Sastry's index, the index of average of all States actual tax effort - termed by him as 'Ideal' and 'Potential' - is questionable; since independent performance of State A is bound to influence the level of potential or ideal tax effort of all States. After all the ideal is not fixed one but an uncertain, fickle and relative one. While Index of equal tax burden may be called 'Ideal' one, fundamental limitation lies in selecting the rates of tax of different income groups since selection of rates of taxation of either rich or poor States would result in injustice to one or other States. Value judgements as to the equitability of the rate of taxation of different income groups of particular State limits its practical application. Quantum tax targets method is in fact no method at all. Since this has been widely used in assessing the performance of the States and from the view point of fiscal adjustments this method is important it has been given some detailed consideration. 1

From the view point of this thesis results emerging from the application of methods 1, 2, and 3 are mentioned below. Before that, an examination of the contention that States as a whole failed relative to Union's performance has also been undertaken now with reference to (a) States taxes as per centage of National income as compared to Centre's per centage in National income. (b) Per centage

1. The targets and achievements of additional taxation for States in Indian Union during the 3 Plan periods are given in Table No. 2.1 on next page.
### TABLE No. 2.1 - TARGETS AND ACHIEVEMENTS OF TAXATION BY STATES DURING 1st, 2nd and 3rd FIVE YEAR PLANS. (Rupees in Crores).

<table>
<thead>
<tr>
<th>State</th>
<th>1st Plan Target</th>
<th>1st Plan Achievement</th>
<th>2nd Plan Target</th>
<th>2nd Plan Achievement</th>
<th>3rd Plan Target</th>
<th>3rd Plan Achievement</th>
</tr>
</thead>
<tbody>
<tr>
<td>Andhra Pradesh</td>
<td>3.5</td>
<td>3.3</td>
<td>7.3</td>
<td>3.0</td>
<td>10.6</td>
<td>2.3</td>
</tr>
<tr>
<td>Assam</td>
<td>11.0</td>
<td>6.0</td>
<td>10.6</td>
<td>2.3</td>
<td>23.5</td>
<td>24.0</td>
</tr>
<tr>
<td>Bihar</td>
<td>10.6</td>
<td>6.0</td>
<td>39.8</td>
<td>9.0</td>
<td>23.5</td>
<td>24.6</td>
</tr>
<tr>
<td>Gujarat</td>
<td>23.5</td>
<td>24.0</td>
<td>9.2</td>
<td>9.0</td>
<td>9.2</td>
<td>12.8</td>
</tr>
<tr>
<td>Kerala (T.C)</td>
<td>9.4</td>
<td>2.0</td>
<td>9.4</td>
<td>2.0</td>
<td>5.0</td>
<td>4.5</td>
</tr>
<tr>
<td>M.P.</td>
<td>50.2</td>
<td>11.0</td>
<td>5.0</td>
<td>4.5</td>
<td>36.9</td>
<td>4.5</td>
</tr>
<tr>
<td>Madras</td>
<td>36.9</td>
<td>4.5</td>
<td>15.0</td>
<td>10.0</td>
<td>7.4</td>
<td>1.0</td>
</tr>
<tr>
<td>Maharastra</td>
<td>36.9</td>
<td>4.5</td>
<td>15.0</td>
<td>10.0</td>
<td>4.9</td>
<td>2.7</td>
</tr>
<tr>
<td>Mysore</td>
<td>36.9</td>
<td>4.5</td>
<td>15.0</td>
<td>10.0</td>
<td>4.1</td>
<td>0.4</td>
</tr>
<tr>
<td>Orissa</td>
<td>36.9</td>
<td>4.5</td>
<td>15.0</td>
<td>10.0</td>
<td>4.7</td>
<td>2.1</td>
</tr>
<tr>
<td>Rajasthan</td>
<td>36.9</td>
<td>4.5</td>
<td>15.0</td>
<td>10.0</td>
<td>3.4</td>
<td>8.0</td>
</tr>
<tr>
<td>U.P.</td>
<td>36.9</td>
<td>4.5</td>
<td>15.0</td>
<td>10.0</td>
<td>36.9</td>
<td>4.5</td>
</tr>
<tr>
<td>W.B.</td>
<td>36.9</td>
<td>4.5</td>
<td>15.0</td>
<td>10.0</td>
<td>36.9</td>
<td>4.5</td>
</tr>
<tr>
<td>Hyderabad</td>
<td>36.9</td>
<td>4.5</td>
<td>15.0</td>
<td>10.0</td>
<td>36.9</td>
<td>4.5</td>
</tr>
<tr>
<td>M. Bharat</td>
<td>36.9</td>
<td>4.5</td>
<td>15.0</td>
<td>10.0</td>
<td>36.9</td>
<td>4.5</td>
</tr>
<tr>
<td>PEPSU</td>
<td>36.9</td>
<td>4.5</td>
<td>15.0</td>
<td>10.0</td>
<td>36.9</td>
<td>4.5</td>
</tr>
<tr>
<td>Saurashtra</td>
<td>36.9</td>
<td>4.5</td>
<td>15.0</td>
<td>10.0</td>
<td>36.9</td>
<td>4.5</td>
</tr>
<tr>
<td>Jammu &amp; Kashmir</td>
<td>36.9</td>
<td>4.5</td>
<td>15.0</td>
<td>10.0</td>
<td>36.9</td>
<td>4.5</td>
</tr>
</tbody>
</table>

**TOTAL**          | 230.3           | 80.4                 | 230.1           | 80.4                 | 218.2           | 610.0                | 572.42              |

**NOTE:**
1. Andhra area was separated from Madras State on 1-10-1953 and A.P. was formed on 1-11-1956. Hence separate figures for 1st Plan are not available. They were included in Madras State.
2. Gujarat State was formed on 1-5-1960. Hence figures for 1st and 2nd Plan are not available separately. Maharastra figures represent both for Maharastra as well as Bombay for 1st and 2nd Plans.
3. Travancore and Cochin figures for the 1st Plan period.
4. Hyderabad, Madhya Bharat, PEPSU and Saurashtra are later on merged in reorganised States of A.P., Maharastra, Mysore, Punjab and Madhya Pradesh. Hence for subsequent plans separate figures are not available.

**SOURCE:**
1. Cols. 1 and 2 are taken from the report of the F.C(1957) pages 26 & 27 respectively for 1st and 2nd Plan targets.
2. Second Five Year Plan targets and achievements are taken from "Resources for the Third Five Year Plan" publication of Indian Merchant Chamber Economic Research and Training Wing, 1961, p. 123.
3. Targets and achievements for Third Five Year Plan are taken from Art. on "States Finances and Fourth Plan" by D.C.Vohra, E.W. dated 3-4-1966, p. 599-60.
States Tax revenues in the combined total of States plus Centre's tax revenues at two different periods. All States taxes (inclusive of shared tax revenues) increased as per centage of National income from 2.83 in 1950-51 to 3.54 in 1955-56, to 4.56 in 1960-61 and 5.10 in 1965-66. Central tax revenues (excluding tax transfers to States) increased from 4.31% in 1950-51 to 5.06% in 1955-56 and to 8.31% of National income in 1965-66 respectively. All State's tax revenues as per centage of National Income increased in 1965-66 over 1950-51 level by 191.15% while Central tax revenues as per centage of National income grew during the same period by 196.51% which shows that the performance of all States taken together was not after all discouraging. Secondly all States Tax revenues as per centage of combined Central plus State's tax revenues grew from 39.62% in 1950-51 to 41.17% in 1955-56 but in the year 1965-66 they were only 38.03%. This declining trend can very well be explained by the centralisation of some commodity taxes which were till then levied and collected by States. Since local taxation is part of the State's list under constitution, whose aggregate finances are nearly 1.7% of State income of A.P. in the year 1961-62 and whose tax contributions to different States tax finances may also be of equal importance, its inclusion would definitely alter the position in favour of States.

Per capita and per centage methods of assessing States performance during 3rd Plan period are conveniently combined together and presented in Table No. 2.1-A (see next page). From that table the following observations can be made. (1) According to per centage growth of States' income in 1965-66 over 1950-61 (col. 4) Orissa had maximum increase (50-9%) and A.P. had lowest increase (20.7%) amongst States, while for the other States it varied between these two limits. Comparing this increase in States incomes with that of
### Table No. 2.1A

**Comprehensive Growth of State's Incomes, Per Capita Incomes, Total Revenues and Tax Revenues in 1965-66 Over 1960-61.**

<table>
<thead>
<tr>
<th>Name of the State</th>
<th>Percentage Increase in Per Capita Incomes</th>
<th>State Incomes</th>
<th>State Taxes</th>
<th>State Revenues</th>
<th>State Revenues (Tax plus non-tax)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Andhra Pradesh</td>
<td>12.11%</td>
<td>49.3%</td>
<td>20.70%</td>
<td>162.9%</td>
<td>61.10%</td>
</tr>
<tr>
<td>Assam</td>
<td>8.28%</td>
<td>73.0%</td>
<td>21.59%</td>
<td>205.2%</td>
<td>62.50%</td>
</tr>
<tr>
<td>Bihar</td>
<td>28.18%</td>
<td>43.1%</td>
<td>41.49%</td>
<td>163.0%</td>
<td>43.70%</td>
</tr>
<tr>
<td>Gujarat</td>
<td>19.47%</td>
<td>62.0%</td>
<td>34.49%</td>
<td>185.9%</td>
<td>70.60%</td>
</tr>
<tr>
<td>J &amp; K</td>
<td>--</td>
<td>90.6%</td>
<td>--</td>
<td>200.0%</td>
<td>25.50%</td>
</tr>
<tr>
<td>Kerala</td>
<td>8.31%</td>
<td>62.5%</td>
<td>22.76%</td>
<td>183.3%</td>
<td>77.46%</td>
</tr>
<tr>
<td>M.P.</td>
<td>15.30%</td>
<td>68.0%</td>
<td>22.56%</td>
<td>189.3%</td>
<td>62.70%</td>
</tr>
<tr>
<td>Madras</td>
<td>11.33%</td>
<td>63.2%</td>
<td>24.15%</td>
<td>172.7%</td>
<td>50.20%</td>
</tr>
<tr>
<td>Maharashtra</td>
<td>15.80%</td>
<td>60.3%</td>
<td>30.34%</td>
<td>179.9%</td>
<td>65.10%</td>
</tr>
<tr>
<td>Mysore</td>
<td>14.71%</td>
<td>63.5%</td>
<td>29.62%</td>
<td>181.7%</td>
<td>48.40%</td>
</tr>
<tr>
<td>Orissa</td>
<td>38.50%</td>
<td>150.5%</td>
<td>50.90%</td>
<td>219.9%</td>
<td>125.60%</td>
</tr>
<tr>
<td>Punjab</td>
<td>24.79%</td>
<td>73.3%</td>
<td>40.05%</td>
<td>196.8%</td>
<td>77.10%</td>
</tr>
<tr>
<td>Rajasthan</td>
<td>18.60%</td>
<td>64.1%</td>
<td>33.11%</td>
<td>178.2%</td>
<td>59.10%</td>
</tr>
<tr>
<td>U.P.</td>
<td>14.21%</td>
<td>7.2%</td>
<td>26.47%</td>
<td>146.5%</td>
<td>32.30%</td>
</tr>
<tr>
<td>W.Bengal</td>
<td>22.83%</td>
<td>36.3%</td>
<td>33.85%</td>
<td>160.2%</td>
<td>66.90%</td>
</tr>
<tr>
<td>All States</td>
<td>31.22%</td>
<td>174.0%</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Source:**
1) Figures cols. 2 and 3 are taken from Eastern Economist dated 30-3-1962.
2) Col. 6 is estimated from R.B.I. data for States total Revenue excluding grants in aid but including Central Tax transfers.
3) Col. 7 is estimated from F.C.(1965) data. Here only tax and non-tax Revenues of State Govt. are included. Income Tax Union Excises and grants received from Central Govt. are excluded to estimate the growth of State's own resources.
respective States revenues (Col. 6 and see the foot note to the table also) during the same period, we find that Orissa had maximum increase in revenues (125.60%) and U.P. had lowest per centage increase in their revenues. On the other hand if we exclude all transfers from Union Govt., (Col. 7, see foot note to table also) we get a different picture. Thus Orissa had higher per centage increase in its own revenue (Tax plus non-tax) of 189.1%. Other States that had significant increase in their revenues are Jammu and Kashmir (130.4%) Gujarat (122.2%) Punjab (117.3%) and A.P. (103.3%). Further if increases in States taxes exclusively are taken (without reference to non-tax revenues, Union's shared taxes, and grants etc.) during that period, the performance of all States is significant. But, however if all States average increase is taken as standard, all States except A.P., Bihar, West Bengal and U.P. (in decending order) had good performance. (2) Per centage increase in per capita incomes in 1965-66 over 1960-61 (col. 1) indicate that Orissa had highest (38.5%) and Assam had lowest (8.28%) increases. Comparing items in column 3, with col. 1 we find that all States excepting U.P. have done their best.

Coming to per capita per centage method, as was already stated, three different calculations could be made. They are (a) rate of actual taxation (b) the ideal tax effort index and (c) relative degree of sacrifice. The per capita per centage method or the measurement per capita tax as a per cent of per capita income of the State, which Prof. Sastri calls as the actual rate of taxation by itself does not signify whether a particular State has done its best or not, excepting that a mere ranking based on that index can be made. Hence they are given in table No. 2.2. Prof. Sastri's index of ideal tax effort, has operational significance since the degree of adjustment whether mal-adjustment or negative adjustment of each States tax
effort can be estimated and a rational scheme of transfers can be
arranged. Since our aim is one of the locating States that did not
put forth sufficient tax effort, this method is of some use. In table
No. 2.2 (on next page) are given the degree of mal-adjustment - a
positive sign indicates the per centage of excessive tax effort over
the actual tax effort and the negative sign shows the per centage of
slackness of actual tax efforts relative to the ideal tax efforts for
States under both progressive and proportionate scales, for the years
1955-56 and 1960-61. According to this estimation on both progres­
sive and proportionate scales, A.P., Bihar, M.P., and U.P., exceeded
their ideal tax efforts in 1955-56 and A.P., Assam, Bihar, Madras
Orissa, Mysore, Rajasthan and U.P., exceeded their ideal or potential
tax efforts in 1960-61.

According to Mahadevan's index of relative degree of sacrifice
of different States as shown in table No. 2.2 "residents of low income
States (Bihar, M.P., Rajasthan and Mysore) bear heavier burden than
the people of high income States (West Bengal, Punjab and Gujara
At the extreme we may safely conclude that people of M.P. make greater
sacrifice and of Bengal the least". This analysis assumes signifi­
cance, according to Mahadevan, since those relatively well developed
States which rank high in per capita incomes come at the bottom of
the alternative scale which explains the inability of Bihar and M.P.
to reach additional taxation targets in 2nd Plan and scope for the
improvement in the performance of other States.

Nextly, method developed by Mr. Donnahoe requires an alloca­tion of tax revenues collected by States to different income groups
on an appropriate, equitable and scientific basis (such a thing has
not been undertaken here). Further for a comparison of equity of
tax burden on different income groups in different States we require
ideal quantum or rate of taxation of different States whose selection
<table>
<thead>
<tr>
<th>Name of the State</th>
<th>Degree of Mal-Adjustment</th>
<th>Degree of Sacrifice (Index)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Andhra Pradesh</td>
<td>20.76</td>
<td>25.76</td>
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<tr>
<td>Assam</td>
<td>3.71</td>
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<tr>
<td>Bihar</td>
<td>35.06</td>
<td>62.80</td>
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<tr>
<td>Bombay*</td>
<td>17.95</td>
<td>36.50</td>
</tr>
<tr>
<td>Gujarat</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Maharashtra</td>
<td>-</td>
<td>-</td>
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<tr>
<td>Kerala</td>
<td>-</td>
<td>-</td>
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<td>Madhya Pradesh</td>
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<td>Uttar Pradesh</td>
<td>35.71</td>
<td>53.20</td>
</tr>
<tr>
<td>W. Bengal</td>
<td>31.02</td>
<td>53.49</td>
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**SOURCES:**
1. Cols. 2, 3, 4 and 5 are taken from K.V.S. Sastri's Book op.cit. pages 58-61, and cols. 6 to 9 are taken from "States Tax Burden in India" by M.R. Mahadevan in Economic Weekly dated 20-10-62.

**NOTE:**
1. Absence of minus sign indicates plus sign.
2. Cols. 2 and 4 are on proportionate scale and 3 and 5 are on progressive scale. For explanation about the scales vide Sastri's book op.cit. p. 36-39.
3. Cols. 6 and 8 are based on an estimate as given below.
   \[(\text{State's tax Revenue} \times 100) \times \text{Per capita State Income} \]
   \[
   \text{State's Income}
   \]
4. Col. 7 and 9 are arrived by multiplying above index in col. 6 and 8 by the ratio of State's price index to All India price Index.
5. Figures relate to combined State of Maharashtra and Gujarat.
involves value judgements. While this is the ideal method, due to above two troubles, the required exercise has not been taken up.

Since the results of all the above methods, if recollected, present different performances of different States and the ideal index has yet to be constructed, the additional taxation method which was given pride of place by Indian Planners is considered in detail. Further in examining the scope for additional taxation problems of centralisation or rate uniformity, an aspect of fiscal adjustments, can also be discussed, for additional tax revenues can be obtained either by increasing the rate of taxation of a particular tax or by widening the coverage of particular tax net.

**Issues in quantum target taxation method:** As a method it begs answers to several important questions which have been posed and probed now. They are: (1) How is the quantum of additional taxation arrived at? (2) How this quantum is, in turn, distributed between Union and States? (3) How could this additional taxation quota allotted to all States be distributed in between the States? (4) Whether the objective sought to be served by this quantum of additional taxation, namely, the control of inflation as well as supply of more funds, could be achieved by the State Govts. through their tax efforts? Answers to the above questions are attempted in the following paras.

(1) While in the process of estimating internal resources, selection of starting point is arbitrary, certain balancing between different methods of financing through internal resources has to be endeavoured. Balancing between taxation and borrowing, taxation and deficit financing, and raising internal and foreign resources have thus to be attempted. Given other methods of raising finances and their quantum, the gap in the resources should largely be covered either by additional taxation or by deficit financing.
(2) The distribution of additional taxation during 1st Plan between Union and States was based on "estimates made early in 1951" and during the 2nd Plan period on the presumption that "State Govts. are expected to raise between them a total of Rs. 225 crs., and Centre is to raise a like amount". In 3rd Plan on the assumption of "adequate share". How this "share" is derived and what factors were considered in determining its adequacy was not explained anywhere in plan reports. Is there not an element of arbitrariness in the distribution of additional taxation?

(3) Ignoring it, let us see how the quantum of additional taxation so settled is further distributed amongst different States. While there is no indication regarding this aspect in plan reports, the quantum of additional taxation to be raised by States under different tax heads was estimated. Even this break-down of additional taxation quota under different States taxes was also rough. For instance Second Plan points that "target of Rs. 225 crs. of additional taxation to be raised by State Govts., has been determined on the basis of detailed discussion with them and an assessment of the likely yield of various measures recommended by T.E.C." So, additional taxation figures were agreed and were also based on scientific appraisal as recommended by T.E.C. Regarding the first aspect, namely, the agreement, political pressures might have played a significant part since the States, in their eagerness to get a bigger plan outlay, might have agreed initially to undertake the quantum of additional taxation as fixed by P.C. or Union Govt.

1. Memorandum of Madras Govt. to F.C. (1961) opines that additional taxation "fixed by P.C. was not based on fair consideration of taxable capacity and that additional taxation is treated as purely a balancing item in the resource picture". As reported in the Hindu, dt. 15-10-1961.
2. First Five Year Plan, p. 56; Second Five Year Plan, p. 89.
Therefore is not the element of arbitrariness further evident?

Second aspect brings us to the root of the problem. Considering the requirement of finances, T.E.C. concluded that "there is a presumptive case for holding that Indian taxation on the basis of existing tax structure and rates has not fully tapped the taxable resources of the country". But the taxable capacity as understood by fiscal scientist deals with individual tax utilisation and relative taxable capacities of different income groups in different politico-economic situations. T.E.C.'s recommendations were mainly aimed at placing individual taxes, both under Central-State-Local jurisdictions, on a rational basis, keeping the developmental requirements as the basic consideration.

Dealing with the problem of additional taxation, 3rd Plan says that "undoubtedly there are limits to taxation and a number of complex economic and other considerations are involved in working out the concrete measures to be adopted for realising a given target" and "the choice of different forms of taxation has to be made on considerations of existing levels and the likely incidence and the effect of further increases in each direction...The relative merits of each form of taxation have to be determined pragmatically..... The details of tax measures to be adopted during 3rd Plan will have to be decided upon in the light of economic situations as it emerges.

2. For instance while commenting on financial effects of their recommendations on Sales tax T.E.C. said "the adoption of flexible pattern will mean that every State will gain in revenue, in addition to achieving a simple and a more rational system for different classes of dealers". Report of T.E.C. (1953-54) Vol.III, page. 521.
from year to year", 1

Further the theoretical opinion of Prof. Pigou that "when a given amount of additional revenue is required, we shall often be unable to tell what member of any given family of tax formulae - or to take a simple special case, what rate of one or another sort of tax - would yield that revenue, until we know both what amount of revenue is already being raised and what tax formulae are being employed to raise it", 2 confirms the view that the distribution of additional taxation between different tax bases is quite arbitrary and is amenable to value judgements. The assertion of Dr. B.K. Madan that "it is difficult to device taxes designed specially to tap additional incomes in consequence of plan expenditure" eventhough "theoretically it should be easier to take a proportion of new and growing incomes" clearly points that the value judgements are involved.3

1. (a) Third Five Year Plan, p. 102-4. (b) In this connection U.N. Report on "taxes and fiscal policy in underdeveloped countries" (New York, 1954) is worth quoting. Dealing with the "capacities for tax increases" it says that "Yet where the optimum level lies permits of no doctrinaire answer.....As regards to taxation, one of the key factors is whether additional taxes can be so levied as to tap funds that otherwise would have gone into such channels as luxury consumption or socially unproductive investments or foreign exchange hoarding, or whether they would simply displace private productive investment and essential consumption, no categorical answer can be given to this question. How far and how fast can taxes be raised? Only through a careful enquiry into economic characteristics, social and cultural institutions, and prevailing standards of tax administration and compliance can an intelligent approximation be provided for any given country". page, 7. The above remark applies equally to a State Govt. in federal India.


Now granting that additional taxation could somehow be allocated to States, next problem is to know how a State could further distribute the additional taxation under its different Revenue heads. Even this is a matter of value judgment which has to be based on general economic conditions. Supposing that rates of taxes have to be raised, what considerations should be taken into account in fixing new rates? Additional taxation of any single tax base or a group of tax bases rests upon the premise that the increased income of the tax group with the particular tax base(s) was so much that an increase in taxation by an additional amount (through coverage and rate structure) would leave them as they were before their incomes rose, besides providing sufficient incentive to these income groups to work and save so that tax base also increases. In other words the function of additional taxation is to allow tax base to grow while at the same time reduce income inequalities and prevent incidental diversion of resource uses into socially and relatively unimportant channels.

But here the issue is what tax base or rate should be operated, given other tax rates? The optimum distribution of additional taxation in between tax bases and their rates is imperfect. A largely neglected auxiliary analytic tool for finding the most efficient tax-mix is the comparative income elasticity of various taxes i.e., the ratio of tax change to income change. The ratio depends on tax incidence and tax progression, if any. No exact calculation has yet been attempted to find out how much income would increase or decrease, if the tax rates were increased or decreased. Even supposing that only one or two taxes in the State's tax structure can be operated, the problem is whether the rate structure of that tax can be made progressive along with the increments in income.

1. "Fiscal policy for growth without inflation: The German experiment" - by Remss F.C., P. 41; also refer the comment of Prof. K.N. Raj in "Third Five Year Plan and India's Economic Growth", Ed. by B.C. Tandon, p. 61.
In other words, can built-in and formula flexibilities\(^1\) be introduced in any of the State's tax weapons to ensure automatic increases in their revenue? Alternatively, what changes in the rate structure are warranted under the present rate of taxation of each individual State taxes? For all these questions, the answer is negative.

Land Revenue base\(^2\) is quite non-responsive to income changes, Sales tax base is elastic to income changes; and Motor vehicle tax is income elastic.\(^3\) The elasticity of water rates, and electricity duty and public enterprises of the State are not known. Further to what extent built-in and formula flexibilities could be introduced in the States' tax structure is a problem for further enquiry.

It is in this context the remarks of F.C's assume special significance. F.C. (1957), which entirely relied on the additional taxation targets set up by Planning Commission, commenting on the 34.91% of the achievement of tax targets by States said that "the tax effort of many States during this period fell short of the

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(b) A.R. Prest in his "Public Finance in under-developed countries" points that: "To meet the long run growth of expenditure, it is desirable that the tax system as a whole should be income elastic in character. ... This would mean two things (i) that each individual tax should be so arranged that its yield is elastic with respect to National income changes (e.g. a progressive income tax rather than Poll tax) or that those taxes whose yield is highly elastic with respect to National income should be predominant in revenue structure". p. 26-27.

2. Where land was permanently settled, for instance, as in Madras, the land revenue is based on the net income per acre of land for the standard crop according to soil gradation. In Andhra area, the net income of the crop per acre is liable to be taxed. Normally, 50% but in practice less than that percentage is levied as land revenue. Vide Memorandum presented by A.P. Govt. to F.C. (1965) p. 141-43.

3. Co-efficients of elasticity of S.T. and M.V.T. for the period 1948-49 to 1958-59 for all States were 1.22 and 1.91 respectively. For A.P., corresponding coefficients for the period 1957-66 are 0.36 and 0.17 respectively. All India estimates are from Mr. Sahota's "Indian Economic Development and Tax structure", p. 12 and 68 and for A.P. they are calculated by the present author. Vide Statistical Appendix No. 5.
expectations of the Planning Commission".¹ F.C. (1961) even while pointing some instances of inadequate taxation (Land Revenue and Betterment levy), was not sure whether additional revenues could be raised since such conclusion is justifiable if it is based on "comprehensive examination of tax potential of each State and review of the States tax structure and fixation of rates under different heads of levies in the States list".² All these remarks point that additional taxation through variations in rates of different taxes as related to the independent taxable capacity of each State and incomes of tax groups has not been done so far. Therefore, under these circumstances there is equal scope and force in the arguments of States that they taxed sufficiently and that of the Centre that States failed in their efforts.

(5) Let us now examine whether one of the two-fold objectives of levy of additional taxation by States, namely, the control of inflation could be fulfilled by them. Approach from this angle requires the application of techniques for locating geographical and functional surpluses within the State's economy and an assessment of the appropriateness of State's tax structure for achieving that end in any given period. Thus we want the States in a federation to endeavour for the maintenance of monetary equilibrium. Such a thing is unexpected by the States since important monetary and fiscal weapons are in the hands Union Govt. Nevertheless if they are expected to perform such a

function, distribution of responsibility between monetary and fiscal policies on the one hand and different fiscal authorities in a federation on the other present several technical difficulties. For such a purpose we require (a) the flow of funds analysis at any point of time between different income and functional groups together with their consumption functions. (b) The input-output relations of an individual State together with its trade coefficients with other States have to be constructed to give us the information on the quantum of internal physical resources and (c) an index of inflation to allow us to locate the "excess" or "surplus" monetary resources to be withdrawn.

Given the application of these techniques and the results obtained therefrom, the excess demand emanating from factor and product markets will have to be encountered through fiscal measures by timing them appropriately by Central Govt, on the one hand and the...........

1. (a) First difficulty is assessing "the inflationary gap" within State's economy. In this regard the difficulties encountered in assessing and covering inflationary gap are explained by Prof. Milton Friedman in his "Discussion on Inflationary Gap" in "Essays in positive Economics", p. 251-52.

(b) Reasons for eliminating Local and State Govts, from the purview of considerations by Heady; and the suggestion that local units have to be relied upon for implementing federal policies etc. by Milton Friedman may be noted. Vide p. 425-26 and 371-72 in "Readings in Monetary Policy" respectively.

2. "Flow funds analysis" has been published very recently for Indian Economy as a whole vide R.B.I. Bulletin Dec. 1964. Similar data for individual states is the present requirement.

3. Dudley seers in his article "The role of National Income Estimates in the Statistical policy of an under developed area" stresses the need for obtaining statistics regarding the flow of goods (both inflow and outflow) from the area for successful planning. Vide Review of Economics Studies Vol, XX(3) 1953, page 159-168.


5. Ibid, p. 177-81.
State and Local Govts., on the other, Compensatory fiscal action to combat inflationary pressures and timing them by an appropriate authority are therefore the issues. It is accepted that Federal Govt. with its highly elastic sources of revenue alone can operate upon inflation successfully. States, with their existing taxes can influence commodities and services only. Thus they can influence only excess demand in the product market. A further problem is whether it is possible to control excess demand for wage goods by Sales tax and Purchase tax on Agricultural commodities? This issue arises since majority of the projects undertaken by States have long maturity periods which couldn't provide wage goods and services required by the economy, while on the other hand, money payments make to labourers go to swell the demand for wage goods immediately. In this context it has been argued whether Article 286 (3) of Indian Constitution that prohibits taxation of essential commodities is rational. Therefore eventhough monetary surpluses could be located

1. (a) Given the inflationary gap, the distribution (quantitative) of responsibility between monetary and fiscal policies and agencies or levels of Govts. is impossible. Vide "Inflation" by D.C. Hague (Ed) International Economic Association, Articles by Fritz Newmark and H.W. Holtrop respectively.

(b) Fritz Newmark points that "an intended degree of over all flexibility calls for a federal or Central tax system which has to be more elastic the greater the share of other levels of Govts. in the tax total. No matter whether and how a net increase in total tax Revenue is deemed adequate to combat inflation, One may question whether a change in the tax structure helps to check it. However one should refrain from changing fiscal parameters too frequently if they have a big impact on expectations and decisions of entrepreneurs and consumers". p. 192. Indian Union is a case of this nature. Vide T.E. Vol.I p. 15.

2. "Theory of Public Finance" by R.A. Musgrave, p.181-2. Further any short-fall in the performance of lower levels of Govts. has to be compensated by the fiscal actions of higher levels of Govt. In fact it can be shown that it is Union's fisc that failed rather than States, Union with all its elastic sources could not control inflation. The presence of large quantum of unaccounted money, the expansion of U-sector activities, the non-progressivity of so called progressive taxes illustrate the above point. These facts can be verified from the works of (1) Dr. Sahota "Tax Structure and Economic Development" (2) Kaldor; "Indian Tax Reform" and (3) Dr. B.V. Krishna Murty's article on "The Plan and U-sector" in E.W. dated 24-9-60 P. 439-40.

they can't be tapped at that level through commodity taxes, levied by States, for, such a policy will defeat the very purpose of controlling inflation.\textsuperscript{1}

Therefore scientific examination of fixation of additional taxation as well as distribution of that amount under different tax heads by States reveals clearly that it is fraught with practical difficulties involving inevitable value judgements that are questionable on various grounds, and hence precision in either their estimation or achievement is equally impossible. Therefore accusing States performance as below or that they are unwilling to tax their people sufficiently etc. may not be tenable, by and large, on the basis of existing state of technical knowledge of federal fiscal planning.\textsuperscript{2}

RESOURCE MOBILISATION AND RATE UNIFORMITY: - Our interest in resource mobilisation mainly stems from the lessons it can provide for adjustments that may be effected in the taxation process, either by a coordinated action of all States in regard to taxation of individual items of tax structure or any ingredient of tax in regard to the rate structure or changes in the rate structure to suit the variations or increase in State and/or per capita incomes or by transfer of tax itself either to Union Govt. or to a lower level of

\textsuperscript{1} Prof. Gyan Chand pointed that States commodity taxation was responsible for the inflation, vide his Book on "The Menace of Inflation" page, 82-3. In fact Indian inflation, it was shown, was due to raise in agriculture prices that enhanced the cost of living. In fact when once the demand inflation gets a start it results in cost push inflation. On this aspect, vide "Analysis of Inflation in under developed Economics" by N.V. Sovani in "Changing India" p.295-307.

\textsuperscript{2} Note the comment of Dr. S.L.N. Simha: "In discussing Indian tax effort, it is not profitable to consider beyond a point, the performance of Central Govt. and State Govts. separately, without an exhaustive enquiry into the provisions of Indian Constitution regarding the jurisdiction of the two", vide his book "Development with Stability: an Indian Experiment", page 2 57. Note the significance of the words beyond a point, where and how such demarcation can be placed on each individual State Govts. tax effort is the main issue.
Govt., which can optimise public savings through efficient operation of the Tax. From this viewpoint tax proposals made by individual States for mobilising more resources may be examined. However, any attempt at coordinated action in tax sphere or the transfer of tax to higher or lower level implies the presence of scope for further uniformity of tax in the (larger or smaller) area for optimising Revenues. In this context the caution given by T.E.C. that "efforts to attain uniformity should be limited to achieving such minimum degree of uniformity as is necessary for safeguarding best allocation of resources and obviating uneconomic diversion of trade and business activity, without, however, abridging the essential autonomy of States in financial matters" should be kept in mind.

ANALYSIS OF CASE FOR RATE UNIFORMITY: Tax revenue under any particular tax head is the function of both its rate and base; progressiveness of tax rate and the spread of tax base also influences the tax yield; tax yield will also vary with the levels of income. Therefore in any programme of rate uniformity or centralisation the basic issue is: the rate of which state or income group could be taken as representative? When once this rate is settled, what yield can be expected? How many States will have the net benefit by way of reduced rate and how many will be put to much higher strain? - these questions must be answered. Probably the Federal

1. (a) Report of T.E.C. Vol.I p. 156. (b) Also refer Allan Williams article "Fiscal Policy and Resource Allocation" in Public Finances, 1962 No.2, p. 150. Particularly his comment given below may be noted. "Nor is there any reason, in principle, why ostensibly discriminat- ing taxation should be any more distorting than ostensibly uniform ones". Therefore differences in tax rates between different States cannot be decried on a priori ground to show that they are not taxing sufficiently.

2. Thus in a high income region, a given tax yield (additional) can be obtained with smaller rate changes; while in a low income State, same yield requires greater rate variations.
Union as a whole will benefit if high income states are few and the "representative" rate is much nearer to larger number of low income States, since the additional incomes accruing out of rate uniformity are much higher than the losses to public exchequer in high income States. The diagram given below represents this idea.

In figure No.3 deviations of States' rates are themselves not very wide both between rich and poor states; hence rate uniformity is advisable. If poor States are unwilling to tax their people, then rate uniformity or centralisation will certainly bring in larger additional revenues, than the loss due to reduction of effective rate of tax in rich States' (Case No.1). In figure No.2 it can be seen that it will be uneconomical since the loss due to reduction of effective rate will be more than the gain.
One important aspect of rate uniformity is that the Union Govt. may fix minimum level of tax rate for all States, with the power to use discretion to levy additional rate by way of surcharges. This, in practice, is exemplified by levy of Sales tax on excisable goods. Union Govt. has fixed uniform rate throughout the country and the rate variations, to suit regional levels are fixed by States. This seems to be a sensible alternative to complete centralisation.

Particularly, commodity taxation by Union Govt., for raising additional resources is easier and a better substitute to rate variations by numerous States. It may be noted that complete centralisation or rate uniformity may be uneconomical since it aims at uniformity or equity only in matters of tax rate as against efficiency and optimum resource utilisation. Because of these limitations, rate uniformity of individual taxes and items liable to a particular tax have to be judged pragmatically. The rule of the thumb can't be applied. With these ideas in mind, rate variations made by different States are examined. But differences in rates by themselves don't suggest or speak either for rate uniformity or centralisation or the success or failure of States in resource mobilisation. Such an appraisal can be undertaken by P.C. or an independent body suggested by F.C. (1961)\(^1\). Variations in rates made by States in their efforts for resource mobilisation on scientific basis are not undertaken here, but a preliminary examination of rate structure of Sales tax on different goods liable to Union Excise duties suggest that some minimum degree of uniformity can be adopted.

(1) For example, petrol is subjected to single point Sales tax in all eleven States.\(^2\) An examination of rate reveals that Gujarat

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2. The data for the following examples is taken from the table 29 of the report of F.C. (1965).
is levying S.T. only at 0.02 ps. per litre while majority of States are levying at 0.09 ps. or above. Kerala and Punjab are levying at 15% and 6% respectively. U.P. is levying S.T. at 0.07 ps. per litre. Here a minimum rate can be prescribed by Union Govt., probably, it may not be as low as 0.02 ps. of Gujarat or at 0.11 ps., at Maharashtra, but it may be at least 0.09 or 0.10 ps., per litre.

(2) Sales tax is levied on Kerosene under single point tax in majority of States with the rate varying ½% to 7%. In A.P. it is levied under multi point sales tax at 3%. Probably a uniform single point rate say at 5% may be preferable.

(3) Matches are taxed at single point in majority of States. Even in these States the rate varied from 2% in Kerala, Maharashtra, Mysore, and Orissa to 10% in Gujarat. Punjab is levying the tax at ½%. On the other hand Madras was levying at 2% multi-point. Probably multi-point Sales tax at 2% in all States may be appropriate.

Here the changes sought after should, besides bringing uniformity, also result in the larger revenues to the Govt. Further the criteria followed in selecting the point of Sales tax is also dependent upon the organisation of trade and commerce. When once the production, trade and commerce reach a stage which can cope up with both the types of levy, the change in the point of levy can be made to suit the fiscal needs of the States.

TIMING ADDITIONAL TAXATION AND CENTRALISATION:—Planners pointed that "early action" by States is necessary to obtain additional tax resources. The fact that "tax effort has been concentrated in second and Third years of the Third Plan period" by several States throws a suggestion that advance action could have improved the situation.¹ Now the question is whether centralisation of any tax could ensure advance action in tax measures? Probably the answer

could be both "Yes" and "No". "Yes", because decision by a single level of Govt. is much more quicker than that of decisions by 16 States. Such a decision of Union Govt. may have the advantage of advance action but not that of efficiency, since the impact of Union's decision will be uneven and poor State suffer more than the rich or surplus States. The answer is 'No' since the decision cannot be just, as the variations of physical and financial surpluses as well as regional peculiarities that require special consideration could not have been properly covered by the decision of single authority. Hence even from timing point of view centralisation can't be advocated.

NON-UTILISATION OF TAX POWERS BY STATES AND CENTRALISATION.

States could have mobilised larger finances, it is said, had they utilised all the available tax powers as suggested by T.E.C. As an example Agricultural Income tax is often mentioned. In all such cases normally suggestions of T.E.C. are implemented by States, but if some did not implement one or two recommendations the reasons must be probed by a high powered Commission. If the reasons for non-compliance are found to be based on just facts, alternative methods of mobilising funds will have to be explored. F.C. (1961) pointed two clear cases of taxes which have not been exploited. One practical solution to such clear cases of under-taxation or non-utilisation of tax weapons by States in mobilising their resources is that Union Govt. may have to step into States' taxation either by using its residuary powers and levying surcharges on States' taxes or influence them through grants mechanism. This alternative is applicable if such States are few and transfer to Centre can be meaningful. If such States are many in number.

1. Report of F.C. (1961) p. 39. However it did not mention the names of States or their number.
ARRAVERS IN TAX COLLECTION AND CENTRALISATION: - As an indication of slackness in mobilising finances annual accrual of arrears of tax Revenues are pointed, for arguing that resource mobilisation had not been efficient and thereby hinting that collections may improve if these taxes were transferred to Union Govt. F.C. furnished the statistical information on the arrears accrued on account of Land Revenue, Sales Tax and other taxes. In case of Land revenue arrears accrue due to the conditions poverty prevailing in farmers, whose industry continues to be highly susceptible to the vagaries of monsoon and other natural calamities. Centralisation of land revenue to improve collections, is unwise as this involves huge collection costs owing to higher Central Govt.'s salaries than those of State's employees, besides other difficulties. Sales tax arrears are also purely administrative/nature, improvement of which or a change in the tax law or incurring additional costs for clearance of arrears are alternative solutions rather than centralisation which is not a positive solution.

REVENUE FROM PUBLIC ENTERPRISES OF STATES AND CENTRALISATION: - States are operating Electricity generation and distribution, Road transport (particularly passenger transport) and Irrigation, Water supply and some other sundry enterprises on commercial lines. Since the principle of "No profit and no loss" has been discarded long back the problem is whether their financial performance would improve if they are transferred to Union Govt. or in some cases (Road transport) de-nationalisation takes place. Detailed argument is unnecessary to discard the suggestion for centralisation, since it will not solve the basic problem of low net financial results during initial stages of operation. In case of transport (Road) nationalisation the policy needs a positive rethinking, since this is a field wherein private enterprise can operate efficiently and minimise the losses in their own interest. In fact denationalisation of transport under-
takings running on loss continuously may be examined since the original decision to nationalise was purely political one rather than economic one. The conclusion, therefore, is that fiscal adjustment is not the solution to the present state of inefficiency or low rate of profit in State undertakings.

MOBILISATION ON CAPITAL ACCOUNT AND CENTRALISATION: - Small Savings and public debt are examples of resources mobilised on capital account. Since deficit finance (a special resource which is not expected to be indulged in by the States) arises due to shortages on either current or capital accounts it is not considered. Since public borrowings and small savings have also an inverse relation with the tax effort in general and complementary in between themselves,¹ when they are substituted to tax payments by public such a thing has to be probed for effective prevention in future.² Therefore, in the assessment of resource mobilisation, the tax effort on revenue account and Small savings and Public loans on capital account should be viewed together.

Since improvement of Small Savings and Public loans mostly depend upon their organisation as well as incentives to States by way of higher shares in collections, increased States share is a solution for larger amounts to be mobilised rather than centralisation. Prior to 1957 States get 25% of average net collections for the three proceeding years plus 50% of excess over this average. In 1957 this formula was revised and accordingly States get 2/3rds of net collections if they did not raise market loans.

¹. During Second Five Year Plan Small Savings were low because of excessive market borrowings. Vide S.L.N. Simha "Development with Stability" p. 99. Also refer "Mid-term appraisal of 3rd Five Year Plan, p. 40.
². In that case, failure of States tax effort can be correlated with the success of Small Savings and/or public borrowings by State Governments.
otherwise they were to get 1/3rd as their share. Regarding Small savings the reform should be that entire collections should go to the State concerned. Probably a ceiling on the quantum of Public borrowing by States is desirable because of its implications to the future periods and generations. As regards to centralisation of loan function the presumptive case is considered in chapter 9.

ALTERNATIVE APPROACHES TO FISCAL ADJUSTMENT: - Since the experience of resource mobilisation by itself, could not suggest any further changes in the functions and powers of States the alternative is whether fiscal adjustments can be effected on a posteriori premise. It is suggested that land revenue and Sales tax should be centralised. ¹ The transport panel, in its report suggested the necessity for uniformity in Motor vehicle taxation throughout the Union, which implies repeal of octroi duties by several local authorities.² Similarly there is a demand that University Education and Agricultural programmes should also be transferred to concurrent lists from the State lists.

Acceptance or rejection of above suggestions for affecting fiscal adjustments should be based on rational approach and satisfy certain tests.³ For instance, can the centralisation of land revenue of all States assures justice in taxation to the farmer? Centralised Land revenue legislation, it is presumed, is possible since India possesses well organised cadastral survey system in many States; if land settlement based on principles suggested by T.E.C. in those areas where they are not undertaken so far is completed, it is argued,

it will bring a measure of uniformity and hence permits centralisation. On the contrary even the conversion of Zamindari lands into Ryotwari settlement and standardisation of Ryotwari settlement costed huge amounts of compensation and expenses for trained technical staff; while its Revenue gain according to T.E.C. was only Rs. 29.19 crs.¹

As one authority has rightly pointed the "transformation of land tax into a flexible and effective instrument of development finance does not involve any issue relating to the centralisation or decentralisation" but "the reconstruction and revolutionisation of the entire Land tenure and the entire agrarian economy of the country".²

Similarly, centralisation of Sales tax may also be considered. The centralisation of Sales tax was objected by States since they will be losing much elastic source of revenue and even the compensation paid by Union Govt. is not commensurate with the amounts they could have raised in absence of centralisation. The reason is this.....central tax is levied at specific rates, whereas States Sales Tax receipts increased because they are levied on ad valorem basis.³ Therefore it appears that States may not have any objection if additional excise duties in lieu of Sales Tax on certain commodities is levied by Union at ad valorem basis only. Based on this conclusion certain individual commodities may be transferred for the levy of additional excise duties, with an assurance of minimum amount to States as well as the distribution of excess over the guaranteed minimum on either consumption or some other equitable basis.

². R.N. Tripathi "Fiscal policy and economic development in India" p.132.
Even in regard to Motor Vehicle taxation a blanket sanction in favour of centralisation cannot be given.\textsuperscript{1} Since the principles of levy of M.V.T. are uniform in all States and the rate differences by States may be permitted to correspond with their per capita taxable capacity, a minimum rate of tax may be prescribed by Union Govt. Whenever rates of taxation have to be increased to meet the additional revenue requirements of States it must be assured that the tax load per vehicle (under each category) and tax Revenue from this or a particular tax head bears the more or less same proportion in the total revenue of the State. Alternatively the variation in the rates should be related to the rate of growth of State income. Probably the variations in rates may have to be viewed periodically. Thus the case for centralisation of Motor Vehicle Taxation is not strong. Centralisation or transference to concurrent list is no panacea to the ills of University education. Performances of Agriculture can be improved not by centralisation but by assuring proper administration of functions by the existing organisations.

CONCLUSION FROM RESOURCE MOBILISATION: Therefore the conclusion that emerges from the proceeding paras, is that consideration of issues in financial mobilisation can not by themselves indicate any scope for overall fiscal adjustments. Centralisation of Agricultural Income tax or Sales tax, for the matter any other tax, is unwarranted from the view point of equity in regional resource mobilisation. At best minimum rate of taxation for each tax can be settled based on specific case studies. Because of basence of scientific estimation of States capacities for mobilising their revenues, performances of States have been dubbed as "unsatisfactory" or "below the expectations". Based on this judgement it was concluded that "States have not followed dynamic tax policy"\textsuperscript{2} and that "federal ..........

\textsuperscript{1} Centralisation of M.V.T. poses the problems of administration besides being costly.
\textsuperscript{2} R.N. Tripathi "Federal Finances in a developing Economy" p. 100.
structure of Indian Public Finance has not been compatible with the requirements of fiscal policy suited to a developing economy.¹

Thus while there is no reason for the presumption of lower performance by the States, their dependence on Union Govt. for developmental finances has grown and in fact it has become inevitable. But any attempt at reducing that degree of dependence by transferring Central taxes to States for bridging the resource gulf is not only desirable and practicable but also objectionable.² On the other hand, the scope for centralisation of States taxes is also very limited.³ Therefore the alternatives left - Tax sharing, grants in aid and other relevant issues in financial and fiscal adjustments at Macro-level are considered in the next Chapter.

1. R.N. Tripathi "Fiscal policy and Economic development in India" page, 114.