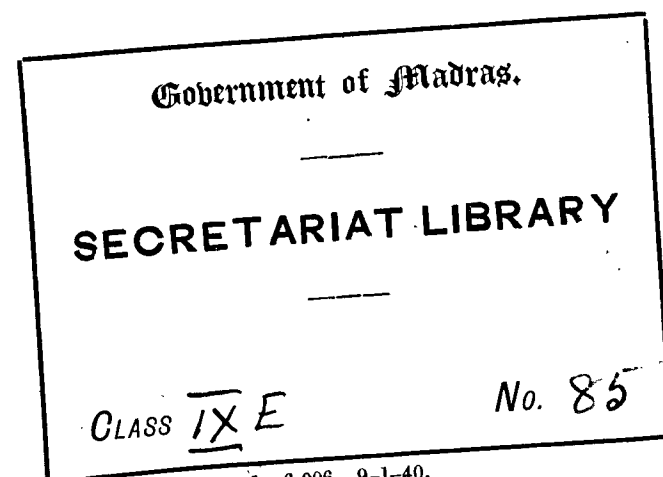


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REPORT

OF THE

FINANCIAL RELATIONS COMMITTEE



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REPORT

OF THE

Financial Relations Committee.

Chapter I.—Preliminary.

As a preliminary to constitutional reforms, the authors of the Montagu-Chelmsford report urged the importance of a complete separation between the finances of the central government in India and those of the various provincial governments. To this end they outlined the scheme described in Chapter VIII of their report. It abrogates the present system by which certain of the main heads of revenue and expenditure are divided between the central and the provincial exchequers; some of these it hands over wholly to the central government, others wholly to the provinces. Inasmuch, however, as by this re-arrangement the Government of India will lose heavily; the scheme proposes to compensate them, to such extent as may be necessary to prevent a deficit in their own budget, by contributions from the provinces; and the power to levy such contributions is taken in section 1 (2) of the Government of India Act, 1919.

2. In assessing this levy the authors of the report met with a serious obstacle in the disparity which already exists between local governments in the pitch of their revenues and the scale of their expenditure, a disparity deep-rooted in the economic position of the different provinces, their revenue history and the tale of their oft-revised financial arrangements with the central government. For this inequality of burdens the authors of the report found no remedy in the several alternative methods of fixing the provincial contributions which they examined. Their ultimate choice fell upon an assessment in the ratio of the gross surplus which they estimated that each province would enjoy under the new allocation of resources. In recognition of the admitted fact that this method would largely affirm existing inequalities, they advised that the whole question should be re-investigated by the statutory commission after ten years' working.

3. The Government of India, in expressing their views on the scheme, pressed for an earlier treatment of the matter; *vide* paragraph 61 of their despatch of the 5th March 1919. They described the feeling which had been aroused against the *prima facie* injustice of the exemplar figures given in the report. They urged that any such settlement should be "recognised as temporary and provisional, and that steps be taken as soon as possible to fix a standard and equitable scale of contributions,.....towards which the provinces will be required to work by stages, as a condition of the new arrangements." They proposed the appointment of a Committee on Financial Relations to advise on the subject. This recommendation was accepted and endorsed by the Joint Select Committee of Parliament which sat on the Reforms Bill. We were accordingly appointed by the Secretary of State, and given the following terms of reference:—

To advise on—

- (a) the contributions to be paid by the various provinces to the central government for the financial year 1921-22;
- (b) 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;
- (c) the future financing of the provincial loan accounts; and
- (d) whether the Government of Bombay should retain any share of the revenue derived from income-tax.



Clause (d) of these instructions was a later addition made at the instance of the Government of Bombay, and was not communicated to us until we had completed our consultations with several of the larger provinces.

4. We formally opened our enquiry at Delhi on the 5th February 1920. We then visited in turn Allahabad, Patna, Calcutta, Rangoon, Madras, Bombay and Lahore. Pressure of time compelled us to ask that the consideration of the cases of Assam and the Central Provinces should be undertaken at Calcutta and Bombay, respectively; and we are indebted to the two Chief Commissioners for meeting us in this request at some inconvenience to themselves. Our procedure was to discuss the subjects of our enquiry in each province with the Member of the Executive Council who holds the financial portfolio, or, in provinces where there is no Council, with the Secretary in charge of the Financial Department, and with such other officials as those gentlemen introduced. Sir Nicholas Beatson-Bell, the Chief Commissioner of Assam, presented the case of his province in person. After taking the official evidence we met those members of the finance committee of the provincial legislature who were ready to favour us with their views. We finally received such members of the general public or representatives of public bodies as offered themselves for examination. In most cases we had informal consultations with the Head of the Province; and the local government of Bombay as a whole accorded us two interviews.

Chapter II.—The Government of India's deficit.

5. In order to effect the desired separation of central from provincial finance, the Montagu-Chelmsford report (paragraph 203) proposes that the central exchequer should receive the whole of the Income-tax and the revenue from General Stamps; and that the provinces should retain the entire receipts from Land revenue, Irrigation, Excise and Judicial Stamps, while they should be wholly responsible for the corresponding charges and for all expenditure in connexion with famine. We read the Joint Select Committee of Parliament as approving this redistribution, and we considered that it would be outside our duty to advise any alteration of the scheme in this respect unless we found the strongest reason for a change. The arguments addressed to us on this branch of the subject have related mainly to Income-tax and General Stamps. Certain local governments have remonstrated against losing a share in those two heads, and the plea for making the whole, or at least one-half, of the income-tax receipts a provincial asset was pressed with special earnestness in Bombay. Under our instructions we have to report on the point for that presidency; but we have found it difficult to treat the issue as applicable to one province only. The grounds of the Bombay claim are common to all provinces, and more especially to those in which large commercial and industrial activities are centred.

6. The basic objection to the transfer of Income-tax is that the provinces will thus be deprived of any share in a head of revenue which has recently shown a remarkable capacity for expansion, while they are left to finance their rapidly growing administrative needs with heads of revenue in which the increase is slow or problematical. How far the remarkable growth of the income-tax receipts in late years has been stimulated by war conditions, we have not attempted to estimate; but we are assured that large improvements are being made in the assessment staff and in their methods, and that a rapid and continuous growth in the return may be counted upon. Several local governments urge that the yield from Income-tax is the only direct contribution to their public revenue which is made by the industrial wealth of their provinces; and governments, which administer great mercantile and manufacturing centres like Calcutta and Bombay, claim special consideration for the heavy expenditure in which those centres involve them. To these arguments the Bombay government added their apprehension that a time may come when a local government may not be anxious to direct, or its officers zealous to enforce, the collection of a tax which brings no grist to the provincial mill. This last contention was put forcibly; but we presume that the Government of India will not be powerless to require the fulfilment by a provincial

government of its obligations under the new constitution, and that public servants will not be remiss in carrying out public duties with which they can be charged by law.

7. We doubt if it will be possible permanently to exclude local governments from some form of direct taxation upon the industrial and commercial earnings of their people; and we recognize the natural anxiety of provinces to retain a share in a rapidly improving head of revenue. But, so far as the income-tax is concerned, we see no reason to vary the scheme of the report. We accept as valid the arguments given by its authors (paragraph 203); indeed, the second of these arguments seems to us capable of further extension in the case of public companies with shareholders scattered over India and elsewhere. We advise, therefore, that the whole of the income-tax proceeds be credited to the central government. Their needs in the near future are likely to be quite as great, and to develop quite as rapidly, as those of the provinces; while we do not apprehend that the richer provinces, such as Bombay, will be seriously handicapped in the administration of their own finances. We append, and shall allude to them hereafter, some figures which indicate that several of the provinces, and Bombay in particular, may look for reasonable elasticity in their revenues apart from the income-tax—an elasticity which will in most cases be encouraged by judicious capital outlay.

Percentage of growth in the last 8 years (1912-13 to Budget 1920-21) under the proposed provincial heads.

Province.	Excise.	General Stamps.	Land Revenue and other provincial heads.	All provincial heads.
Madras	70·24	63·22	11·66	29·06
Bombay	102·57	119·13	32·00	52·43
Bengal	35·91	68·49	13·52	22·30
United Provinces	43·70	45·75	17·13	20·82
Punjab	106·78	73·73	26·86	34·88
Burma	33·15	26·62	33·52	33·65
Bihar and Orissa	24·20	55·29	4·53	11·20
Central Provinces	49·00	48·25	26·30	33·18
Assam	44·26	22·22	20·60	28·00
All the nine provinces	62·27	69·24	20·98	30·48

8. The case of General Stamps is somewhat different. We have approached it, in the first instance, from the point of view of the poorer provinces. Some of these, it seems clear, would start with little or no surplus revenue under the allocation of resources proposed in the report; and this would be both a misfortune in itself and at variance with what we believe to be the intention, if not the implied promise, of the report. No remedy suggests itself except some extension of the schedule of provincial heads; doles and temporary assistance would be inconsistent with the whole policy. In this view, and also because it will greatly facilitate our initial distribution of the central deficit, we advise that General Stamps be made a provincial head throughout. The arguments in the report for crediting it to the central government have not the same force as in the case of Income-tax. We are not disposed to see grave disadvantage in different rates of stamp duty in different provinces, at least on some of the transactions for which duty has to be paid; and any uniformity which may be decided to be essential can always be secured by central legislation. Moreover, in this part of the arrangements there is still the taint of a divided head, for General and Judicial Stamps are controlled by the same agency, and there is a good deal of miscellaneous work and outlay common to both. To make the whole of the Stamp revenue provincial would secure a genuine and complete separation of resources; and we trust that the reasons for this course will outweigh the

only consideration on the other side, to wit the extent to which the deficit in the all-India budget will thereby be increased.

9. That deficit we accept, subject to certain arithmetical adjustments described below, as amounting in the year 1921-22 to 10 crores, composed of the 6 crores previously estimated by the Government of India *plus* 4 crores for the loss of General Stamps which we propose. We have carefully examined the basis of this calculation. Clearly, we have no authority to criticise the military and financial policy on which it so largely rests; and we have restricted ourselves to a scrutiny of the budget arrangements of the Government of India, past and present, and of the normal growth of their revenue and expenditure. Factors of great uncertainty,—the needs of India's defence, her tariff policy and the future of exchange among others,—complicate the estimate; but we are satisfied that the Government of India have made reasonable allowance for those considerations in their forecast of the immediate financial future. On our tour in the provinces, it has been pressed upon us that the Government of India ought to meet their own deficit by special taxation, and a high protective tariff has frequently been mentioned to us as an easy solution of the problem. On this latter question we naturally express no opinion; but we cannot see that the Government of India would have any justification in imposing special taxation to make good their initial shortage of revenue, at a time when the shortage in question will be more than counterbalanced by the additional resources enjoyed by local governments. As we have said therefore we accept the estimate of the normal deficit for the first year of the new constitution. We cannot conceal from ourselves the disadvantages in ordinary circumstances of a system of provincial contributions, and we anticipate that the Government of India will direct its financial policy towards reducing those contributions with reasonable rapidity, and their ultimate cessation. We recognise that it would be imprudent on the part of the central government to give any guarantee of the precise pace of reduction; but we think that a formal enunciation of the general policy would go some way to allay apprehensions which have been expressed to us. Such a policy would clearly be subject to the important reservation mentioned in the report, by which the central government must remain empowered to levy special contributions, by way of temporary loan or otherwise, from the provinces in the event of any crisis of first importance.

10. In arriving at the figure which has actually to be distributed over the provinces, we have had to make certain adjustments. One of these is special and local, and we may dispose of it at once, on the clear understanding that our treatment of the matter is entirely subject to the approval of the Government of India. It relates to the incidence of the cost of the military police force in Burma. The government of that province, we understand, is discussing the point with the Government of India; and their view, as expressed to us, is that 68 per cent. of the expenditure on the force is incurred for frontier defence and ought to be a debit to the central power. The figures originally before us had suggested a division of the cost of the force equally between the Government of India and Burma; but the local government now presses for more generous treatment, and estimates that the share of the outlay on the military police which is equitably chargeable to the province is only 17.42 lakhs against the 31.58 lakhs which had been taken in an earlier calculation. Subject to the assent of the Government of India, we have provisionally accepted this view; and we are reducing the provincial expenditure accordingly, and making an equivalent addition to the charges, and thus to the deficit, of the central government. The main adjustments that have been suggested, however, are concerned with the payment of pensions. At present the central government is debited with all civil pensions drawn outside India, whether the pensioner has served in a province or in an imperial department, and no debit is raised against the provinces concerned. On the other hand, pensioners whose service has been under the central government are paid by the province in which they reside, which receives nothing in recoupment. It has been suggested that pensions paid outside India ought to be debited to the provinces when they are paid to provincial servants, and simultaneously

that the Government of India should relieve the provinces by paying their own pensioners. So far as the future is concerned, the propriety of this change is beyond question. Doubts, however, occurred to us regarding existing payments. Exchange complications and difficulties of exact allocation interfere with precision; while other and more general considerations point on the whole to the advisability of retaining on the books of the central and provincial governments respectively the pensions for which they are at present responsible. We advise, therefore, that the readjustment of debits should take place only for pensions sanctioned on or after the 1st April 1921, and that pensions drawn before that date should be allowed to work themselves off on the present footing; this arrangement being definitely made a feature in the new financial settlement. We may note incidentally, with reference to a point raised by the Punjab, that provinces have no claim on any annuity fund in respect of those members of the Indian Civil Service from whose pay a 4 per cent. deduction has until recently been made under the general rules in the Civil Service Regulations. There is in fact no annuity fund in such cases, and the deduction has simply lapsed to provincial revenues. The result of our recommendations in this matter is that it does not necessitate any immediate change in the all-India deficit; the net growth of their pension liabilities in future is a relatively small matter for which the provinces may be left to make provision without special assistance. The last adjustment to be made is on account of leave allowances drawn outside India. Those are paid at present in the same way as pensions drawn outside India; in future they ought certainly to be debited to the provinces concerned. The normal liability on this account can approximately be calculated, and the Secretary of State has given us a figure of £311,000 for the nine provinces affected by our enquiry. We have converted this at two shillings to the rupee, distributed the liability among the provinces; and subtracted 31.10 lakhs from the Imperial charges and deficit. The latter thus works out to 10 crores *plus* 14.16 lakhs for the Burma Military Police *minus* 31.10 lakhs for leave allowances; or 9,83.06 lakhs net.

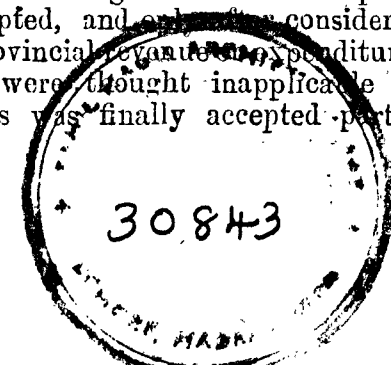
Chapter III.—The initial contributions.

11. We can now proceed to fix the ratio in which each of the nine provinces should contribute to this figure of 9,83 lakhs in the year 1921-22. It will clear the ground to state at the outset a limiting consideration by which we have felt ourselves bound. This is an obligation to leave each province with a reasonable working surplus,—a surplus which we should prefer to calculate, so far as possible, with some relation to the general financial position of the province and the more imminent claims upon its resources. From the preliminary enquiry conducted at Simla in October last, it is apparent that in certain provinces no surplus at all, and in others no adequate surplus, would have been possible without provincialisation of the revenue from General Stamps; and our task would thus in our judgment have been futile. Looked at somewhat differently, the limit we have imposed on ourselves is that in no case may a contribution be such as would force the province to embark on new taxation *ad hoc*, which to our minds would be an unthinkable sequel to a purely administrative rearrangement of abundant general resources. This limit, however, obvious as it is, makes it inevitable that the initial contributions should be in some measure arbitrary, dictated by the existing financial position of each province and not by any equitable standard such as its capacity to pay. Whatever standard ratio of contributions we might advise,—and a subsequent chapter will narrate our proposals in that direction,—it would have, were it to be applied immediately, the effect of starting some provinces on their new career with a deficit, and we have thus to accept some measure of transition.

12. We have now to explain our reasons for suggesting a departure from the basis of initial contribution proposed in the Montagu-Chelmsford report. We are aware that that basis was not lightly adopted, and only after consideration of various alternative bases,—population, provincial revenue, expenditure, and the like—which for one reason or another were thought inapplicable to existing conditions. The basis of realised surplus was finally accepted partly

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because of the difficulty of finding a preferable alternative, partly because at all events it did not add to, though it continued, existing disparities of contribution. That it has been freely criticised in evidence before us as inequitable is certainly not fatal to it, for indeed every initial basis that can be suggested is open to some such criticism. But examination has revealed some objections to it which weigh with us.

13. Obviously if any inequalities of contribution exist, the basis chosen tends to stereotype them, while by disclosing them it renders them more difficult to justify; for each province is now able to see more clearly than under the former system its relative contribution to the purse of the Government of India. While actual deficits appear, as has been said, in some provinces, others complain that their apparent surplus, if rightly understood, masks a real deficit. The prospect of arriving at any accepted figures as a basis appears remote. While the figures of the Simla conference as to normal provincial revenue are accepted with minor modifications of detail, the estimates of normal expenditure in each province are strongly contested. 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 penalised 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, 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? No satisfactory result seemed likely to be reached by our attempting to act as a court of appeal in contentions of this kind. Moreover the artificial and temporary nature of the basis cannot be overlooked. It is too much determined by mere accidents of budgeting in spite of attempts to clear away abnormalities of expenditure. But even if a normal surplus can be agreed at the moment, it tends to be obscured or to disappear in the budgets of succeeding years. How could a contribution be levied in later years on the basis of a so-called normal surplus which did doubtless once exist and might be said to be implied in the economic life of the province, but which in fact had disappeared to be replaced by a totally different surplus or perhaps by a deficit? The best argument for the basis of realised surplus was that, when originally recommended, it did recognise existing facts, that it appeared to leave all the provinces collectively with improved finances and each individual province with a surplus, and that it proceeded upon the principle of creating the minimum of financial disturbance in introducing the Reforms scheme.

14. But these advantages can be secured by another solution, which after careful consideration we think is less open to question. It must be noted that even if the original classification of sources of revenue in the Montagu-Chelmsford report is strictly adhered to, each one of the provinces gains something in revenue, while some gain very substantially, in consequence of the introduction of the Reforms scheme. If our recommendation as to General Stamps is accepted, the net increase in the total income of all the provinces taken together works out at 18,50 lakhs. These additional resources represent what the central government loses and the provinces gain under the redistribution. Some part of them the former may reasonably retain and the latter forgo, so long as contributions to the central government remain necessary. Even those provinces which were found at the Simla conference to be in deficit secure some improvement in their revenues under the original classification, an improvement which will of course be increased by the addition of General Stamps. It has been urged upon us that this increased spending power will in fact be swallowed up by the higher cost of administration, by improvement of old services, or by inauguration of new. At this stage, however, we are considering merely the revenue side of the account. These future liabilities would have had to be faced by each province, if no Reforms scheme had come. Each province is the better able to face them by reason of the additional resources it has

secured. There is the advantage that the figures of normal revenue laid down at the Simla conference, have been submitted to local governments, and with minor amendments, which we have been able to accept, are agreed as arithmetically correct. We propose, subject to the limiting consideration referred to in paragraph 11, to assess the initial contributions on this increase of spending power in the provinces. The proposal has the merit of proceeding on the lines of minimum disturbance of the financial position in each province. It will enable us to comply with the requirements of leaving each province with a surplus, and of inaugurating the new Councils without the necessity of resort to fresh taxation.

15. It is of importance to realise the nature of this transaction. In the first place it implies no judgment on the merits of previous financial settlements with any province. The increase in revenues comes to the provinces as a windfall, or as a bye-product of a constitutional change. It is not due, as financial settlements have been in the past, to consideration of the financial needs of individual provinces. It cannot properly be quoted as an admission of financial inequalities or as an act of tardy justice to the provinces that gain by it. Clearly it has come about from political and not primarily from financial motives. It originates in the desire to secure a greater measure of devolution in the provinces, and in the endeavour to draw for this purpose a defensible line of financial partition between local governments and the Government of India. While we consider that a windfall of this nature affords a suitable basis for initial contributions by the provinces, it is not surprising to find that its application requires some modifications in view of individual circumstances.

Secondly, on this basis the system of contributions appears in a less invidious light. The central government in the course of a political reconstruction gives to each of the local governments some, and to some local governments a very considerable, increase of spending power. Finding itself in a deficit as the result of this reconstruction, it withholds from each province a certain proportion of the increased resources which it is intended that the province should eventually obtain. The central government does not come in as raiding the hard-won surplus of a province; nor ought the central government to be represented, if our proposal be accepted, as the pensioner of the provinces. It can hardly be contended that a province, which has at all events decidedly improved its finances as a result of the change, has valid ground of complaint, if it does not obtain immediately the full increment which it may subsequently realise. In the cases of the provinces that gain most, it would hardly be possible for any such province to spend in the first year the whole of its suddenly increased resources; and if it were possible, it would be financially undesirable. We think therefore that this basis affords less scope for controversy and may be accepted as both more logical and more equitable than the plan of the Montagu-Chelmsford report.

16. A detailed calculation (of which copies are being handed to the Government of India) has accordingly been made, to ascertain the net additional revenues with which each province will be endowed by the new allocation of resources. Starting on the assumption that our proposal about General Stamps will be adopted, we have worked on the figures of normal income which were accepted at the Simla conference and on figures similarly accepted when we came to tabulate the expenditure which will be transferred to and from the provinces. We took the calculations with us on tour, discussed them with the officials of each province, and made several corrections at their instance. The figures of increased spending power on which we ultimately acted may be regarded as agreed figures. Certain provinces urged that they are unduly favourable to our argument, as the great rise this year in the income-tax receipts means a correspondingly greater loss to local governments when they cease to enjoy a share of those receipts. Precision however clearly demands that all our standards should be based on figures for the same year; and there would be no advantage in elaborating a series of normal statistics different from those which were specifically prepared to assist us in our enquiry. We were also pressed to make allowances for schemes of future expenditure to which special importance was attached; but to this we have been unable to accede, as it is not our task to make budget forecasts.

17. Having arrived in the manner indicated at the extra spending power which will accrue to each province, we first considered the possibility of securing the all-India deficit by an even rate on all the provincial figures. So far-reaching, however, is the disparity in the financial strength of the provinces that even this apparently equitable arrangement would in some cases have caused hardship. The extreme case would be that of a province which has been depending largely on doles from the central exchequer; and difficulty arises wherever the provincial revenues are so pinched that the new resources have had to be seriously discounted to provide for the normal expenditure. We have therefore had to consider each province on its merits, reying both on the abundant statistical information which was placed at our disposal and on the insight which we gained into the general situation by our local consultations with the best expert opinion. Our recommendations may be conveniently set out in the following statement, which explains itself when read with the succeeding paragraphs :—

[In lakhs.]

Province.	Increased spending power under new distribution of revenues.	Contributions as 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
	18,50	9,83	8,67

18. The provinces which caused us most anxiety were Burma and Bihar and Orissa. In the former the coming improvement in its revenues has been largely discounted by the heavy commitments necessary to give Burma the reasonable administrative conveniences which it now lacks. The province, as we have satisfied ourselves, is far behind India proper in what its government does for the people. Profits flowing from the rice control scheme, and a wise outlay of borrowed capital, should enable rapid progress now to be made; but the heavy recurring expenditure which development entails will be more imminent than the new income which it will yield. We are convinced that a very substantial share of the surplus revenues of this province should be left free, and our calculations have led us to fix on them only about 6½ per cent. of the total deficit; this happens, as will be seen below, to equal what we determine as the standard ratio of contribution. In Bihar and Orissa the local government is quite the poorest in India, and very special skill will be required in developing its resources. Heavy initial expenditure lies in front of what is still a new province; and there is a wholly abnormal want of elasticity about its revenues. We cannot advise that any share of the deficit should be taken from Bihar and Orissa in 1921-22; and we expect that the province will be sufficiently burdened by having to work up to its standard ratio of contribution in the same period as the rest of India.

19. The two provinces which come next in difficulty are the Central Provinces and Assam. They have a small margin at the best of times, and their need for development is great. The former has a more rapidly expanding revenue than the latter, but on the other hand its finances are more liable to disturbance by famine. On the whole we do not feel that it would be just to ask more than roughly 40 per cent. of their windfall in both cases, and we have based our recommendations accordingly.

20. The special treatment of these four provinces left us with 882 lakhs to allocate among their five richer neighbours; and this sum would be secured

by a flat rate of about 60 per cent. on their new revenues. After the most careful scrutiny of their various peculiarities, we see no marked necessity for differential treatment *inter se*. In Madras and the United Provinces the windfall is so vast that it could not be employed profitably for several years. On the other hand their revenues do not promise any remarkable elasticity, economy has been strictly practised, and considerable arrears of administrative progress are now due. In the Punjab also the windfall is large and balances are full, while here the revenues move upwards with marked ease. The position is less simple, for diverse reasons, in Bombay and Bengal. The former has attained a scale of expenditure far above the Indian average, and the pace of expansion of its revenues is distinctly higher than in any other province. We believe that it could without inconvenience forgo the greater part of its new resources at the outset, and help the less fortunate provinces from its own abundant balances. But we hesitate to differentiate it prejudicially from the other richer provinces. Bengal on the other hand has a low scale of expenditure and an inelastic revenue; and it will receive only a very moderate start in its new financial career. But its size, intrinsic wealth and general economic possibilities prevented us from treating it more favourably than the other provinces in this category.

21. On a general view of the table the heavy contributions of Madras, the United Provinces, and the Punjab doubtless call for comment. Between them these three provinces have to bear 35½, 24½, and 18 per cent. respectively, of the total initial contribution, making 78 per cent. of the whole. Conversely the light assessments of Bengal and Bombay, contributing 6½ and 5½ per cent. respectively of the levy, will be noticed. But the character of the transaction as described above must be borne in mind. If the contribution represented some new and additional burden extracted from the wealth of the provinces, objection might fairly be taken. But it really amounts to the requirement that Madras is called upon to content itself in the initial year with an improvement in its revenue of 228 lakhs instead of a possible maximum of 576; the United Provinces with an improvement of 157 lakhs instead of a possible 397; and the Punjab with an improvement of 114 lakhs instead of a possible 289. The weight of the contribution by the provinces is the best index to the amount of their gains, both immediate and, as will be seen, eventual under the new financial scheme. Just because immediately they are substantial gainers, they can best afford to postpone the full enjoyment of their ultimate advantages.

22. If on the other hand it is urged that some provinces, Bengal and Bombay for instance, escape too lightly under this assessment, the answer is twofold. In the first place they are light gainers in the new distribution of revenues, Bengal having a gross gain of 104 lakhs and Bombay of 93. Secondly, we have not overlooked the claim of certain provinces to exemption from the levy in virtue of their indirect contributions through customs and income-tax to the Government of India. While this claim is often over-stated and exaggerated, we recognise that provinces with commercial capitals such as Calcutta and Bombay make larger contributions through these channels than purely agricultural provinces; and it will be noticed that those provinces where payment to the Government of India through customs and income-tax is presumably highest, make a light contribution to the provincial levy.

Chapter IV.—The Standard Contributions.

23. Our recommendation as to the ratio on which the provinces can properly be called upon to contribute to the deficit of the Government of India in the first year of contribution (paragraph 17 above) is based, as already stated, upon consideration of their present financial positions and of the immediate improvement which will be effected therein by the re-distribution of revenues under the Reforms scheme. This ratio is not intended in any manner to represent the ideal scale on which the provinces should in equity be called upon to contribute; nor is it possible that it should do so. In making our recommendation 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. It is necessary, but it is necessary only in order to give time to the provinces to adjust their budgets to a new state of affairs; and we are clearly of opinion that no scheme of contribution can be satisfactory that does not provide for a more equitable distribution of the burden of the deficit within a reasonable time.

24. The ideal basis for such an equitable distribution can be stated with some certainty. To do equity between the provinces it is necessary that the total contribution of each to the purse of the Government of India should be proportionate to its capacity to contribute. Unfortunately the application of this principle in practice presents many difficulties.

25. The total contribution of a province to the purse of the Government of India will consist in future of its direct contribution towards the deficit, together with its indirect contribution (as at present) through the channels of customs, income-tax, duties on salt, etc. Evaluation of the amount of this indirect contribution involves an exact arithmetical calculation of the proportion of the total sum collected under each of these heads of revenue which is properly attributable to each province. For such a calculation the statistical information available as to the distribution of the revenue between the provinces is not adequate. Under the head of customs, the locality in which dutiable articles are consumed cannot be traced with sufficient accuracy; under that of income-tax, questions of the utmost complexity arise as to the true local source of the income assessed,—questions which the information in the hands of the assessing officers does not enable them to answer. We have nevertheless carried our investigation into this matter as far as available information permits, and by means of an examination of the statistics concerning the distribution of articles which have paid customs duty, and of those concerning the place of collection of income-tax, together with a review of the more general circumstances of the economic life of the provinces, we have found it possible to arrive at an estimate of the weight which should be given, in fixing the basis for equitable contributions by the provinces, to their indirect contributions.

26. Turning to the other circumstance which must be considered in fixing the ideal basis for an equitable distribution—the capacities of the provinces to contribute—we find practical difficulties no less great in the exact arithmetical calculation of the quantities involved. The capacity of a province to contribute is its taxable capacity, which is the sum of the incomes of its taxpayers, or the average income of its tax-payers multiplied by their number. In this connection also the statistical information available does not permit of any direct evaluation. Enquiries of much interest have been made at various times with a view to calculating the wealth of the respective provinces, or the average income of their respective inhabitants, and the results provide much useful information; but in the absence of any general assessment of incomes, and of any census of production, they cannot be considered reliable as a direct estimate, of the quantities concerned. In the absence of any such direct estimate, various circumstances have been suggested to us as capable of serving, taken separately or together, as an indirect measure of the relative taxable capacities of the provinces. Amongst these may be mentioned gross population; urban and rural, or industrial and agricultural population; cultivated area; provincial revenue, or provincial expenditure; amount of income-tax collected; and, more indirect, amount of salt or of foreign textile goods consumed in each province. As measures of comparison all these are open to obvious criticisms, both on theoretical and on practical grounds. We are of opinion, however, that some of them are not without their value as a substitute for the direct information which is not available and they have indeed assisted us in coming to a general conclusion

as to the relative taxable capacities of the provinces. But we are also of opinion that none of them is capable of serving, either alone or in conjunction with others, as an accurate or even an approximate arithmetical measure of those capacities.

27. For the reasons given we believe it to be useless to attempt to state a formula, to serve as a basis for a standard ratio of contributions, capable of automatic application from year to year by reference to ascertained statistics. Although the formula could be stated, the statistics which would be needed for its application are not available. But 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 and equitable distribution of the burden of any deficit. In arriving at this ratio we 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. After estimating, to the best of our ability, the weight which should be given to each of these circumstances, we recommend the following fixed ratio as representing an equitable basis for the relative contributions of the provinces to the deficit.

Standard Contributions.

Province.	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 per cent.	

28. This in our opinion is the ratio which the provinces should in equity be called upon to contribute after an interval of time sufficient to enable them to adjust their budgets to the new conditions. We further recommend that the interval allowed for adjustment should not be unduly prolonged. The initial ratio which we have proposed is a practical necessity, but the provinces which will be called upon to pay thereunder more than they should pay in equity, ought not to be required to bear that burden for a longer period or to a greater extent than is required to prevent dislocation of the provincial budgets. We propose, therefore, that contributions should be made on the standard ratio to any deficit that there may be in the seventh year of contribution, and that the process of transition from the initial to the standard ratio should be continuous, beginning in the second year of

contribution, and proceeding in six equal annual steps. The following table shows the initial, intermediate, and ultimate ratios of contribution for the seven years, in accordance with our recommendations. The initial ratio is the rate per cent. of the actual initial contributions recommended in paragraph 17 above.

Per cent. contributions to deficit in seven consecutive years, beginning with the first year of contribution (rounded off to even halves).

Province.	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
	100%	100%	100%	100%	100%	100%	100%

29. It should be observed that, if the Government of India fulfil their announced intention of gradually wiping out their deficit, against any increase in the proportion which a province will be called upon to contribute from year to year, there will be set off a reduction in the total to be contributed.

30. The scheme of contribution that we recommend above complies we believe with the two essential conditions, that any immediate dislocation in the provincial budgets must be avoided, and that the admitted inequalities of the proportions in which, in the past, the provinces have contributed to the purse of the Government of India, must be rectified within a reasonable time. The scheme is subject to the disadvantage that the ratio which we recommend is fixed, and cannot hold good for an indefinite period. We are of opinion however that it will do substantial equity between the provinces until such a period of time has passed as may be required to effect a very substantial change in their relative states of economic development, a change scarcely to be effected in less than at least a decade.

Chapter V.—Provincial Loan Account.

31. The future financing of the Provincial Loan Account is a less controversial subject than the others that we have had to investigate. It is commonly agreed that it is the natural result of the Reforms scheme that the provinces should for the future finance their own loan transactions, and that joint accounts of this nature between them and the Government of India should be wound up as quickly as possible. In our discussions of this subject with the provincial governments we have found little or no difference of opinion as to this, and our task has been only to ascertain the wishes of the provincial governments as to the amount of its account which each can take over on April 1st, 1921, and how soon it can take over the rest.

32. The Governments of Bengal, the Punjab, the Central Provinces and Assam signified to us their willingness to take over the whole of their respective loan accounts on April 1st, 1921; and we recommend that it should be arranged for them to do so. In some cases it was stipulated as a condition that the

provincial government should be allowed to use for the purpose any part of its balance, including the earmarked portion. We see no objection to the condition, which accords with the intention expressed in paragraph 208 of the Montagu-Chelmsford report.

33. The Governments of Bombay, the United Provinces, Burma, Bihar and Orissa signified to us their willingness to take over a portion of their provincial loan accounts on April 1st, 1921, and the remainder in instalments, to cover varying periods. The Government of Madras alone expressed unwillingness to take over any part of the account. Evidence was given before us, however, by officials of that government to the effect that they would not object to do so if the transfer could be effected by fresh credit arrangements. In view of this and of the great improvement which will be effected in the financial position of the province by the redistribution of revenues under the Reforms scheme, we are of opinion that there is no reason why Madras should form an exception to the general scheme for the transfer of their accounts which we recommend below for application to those provinces which are prepared to take over a part of their accounts forthwith.

34. In the case of those provinces, namely Bombay, the United Provinces, Burma, Bihar and Orissa, and including, as stated, Madras, we recommend that the Provincial Loan Account should be "funded," at a rate of interest calculated at the weighted average of the three rates of 3½, 4½ and 5½ per cent. now paid on varying portions of the account. Whatever portion of the account so "funded" the province is prepared to take over forthwith should, we recommend, be written off against an equal portion of the provincial balance as from April 1st, 1921: and the balance of the "funded" account should remain outstanding as a debt from the province to the Government of India. On the outstanding balance the province should pay interest at the calculated average rate, and also an annual charge for redemption enough to redeem the debt in a fixed number of years, which should not save in exceptional circumstances exceed twelve. The provinces should further have the option to make in any year a larger repayment than the fixed redemption charge.

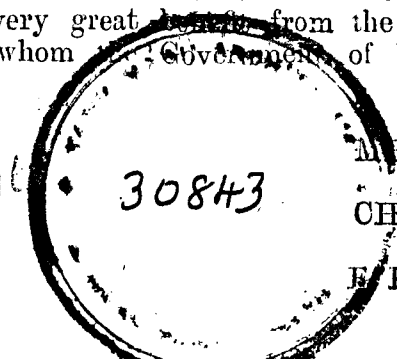
35. The provinces in question will probably not be in a position to state the exact proportion of their respective accounts which they are prepared to take over, or the exact number of years that they will require to repay the balance, until their closing balances on April 1st, 1921, are more precisely ascertained, and also until they know what contributions will be required from them. It appears therefore that these details must be left for determination by future negotiations. We are, however, of opinion that a maximum period of twelve years is ample in order to enable any province to clear its account and that in some cases the period may with advantage be substantially reduced. We further consider that the fixing of a definite term of repayment and the provision of an annual charge for redemption within that term are essential in order to secure the desired clearing of accounts between the provincial governments and the Government of India.

Conclusion.

36. Several other matters were referred to us in the course of our enquiry, on which a recommendation appeared to us to be outside the strict scope of our reference. We propose, however, to communicate our views upon some of them informally to the Government of India.

37. In conclusion we wish to express our indebtedness to our secretary Mr. Dina Nath Dutt, for his careful and methodical assistance in our work. We have also derived very great benefit from the association with us of Mr. G. G. Sim, C.I.E., whom the Government of India attached to us as liaison officer.

31st March, 1920.



ESTON.

CHARLES ROBERTS.

HILTON YOUNG.

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