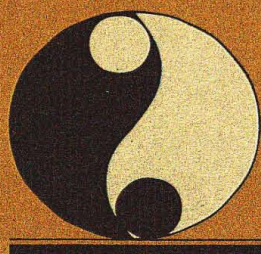


# **Journal of Indian School of Political Economy**

**Vol. VIII No. 1  
January-March 1996**



**A Journal  
devoted to  
the Study of  
Indian  
Economy,  
Polity, and  
Society**



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## ANNOUNCEMENT

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### **AN APOLOGY**

Prof. V.M. Dandekar passed away on July 30, 1995.

An Obituary was published in the Journal of Indian School of Political Economy, July-September 1995. We, the Publishers of this Journal, express our deep regrets at having inadvertently published the same Obituary also in the next issue of the Journal, October-December 1995.

**New Age International (P) Ltd., New Delhi**



# SALES TAX IN INDIA SINCE 1938

M.M. Sury

*Sales Tax is the most intricate and controversial aspect of the Indian tax system. This article describes and analyses different aspects of sales tax in India such as historical evolution, nature and problems, and alternative remedies for its simplification and rationalisation.*

## INTRODUCTION

Sales tax is normally an *ad valorem* levy imposed on the seller with reference to the transaction of sale. On the basis of the stage of collection, sales tax is classified into (a) multi-point sales tax, and (b) single-point sales tax.

### *Multi-Point Sales Tax*

As a multi-point levy, sales tax may be applied at two or more stages of production and distribution and becomes akin to a turnover tax applicable at each transaction of purchase and sale. Multi-stage sales tax is politically expedient. A given amount of revenue can be raised at a lower rate of taxation which also reduces the temptation for tax evasion.

The chief demerit of multi-point sales tax is its encouragement to vertical integration of production and distribution processes. Thus, it discriminates against non-integrated firms. Producers of finished products prefer to produce their own materials and components, and this tendency harms the interest of independent suppliers, particularly small ones. Furthermore, multi-point sales tax discriminates against those goods, and their consumers, which have to pass through numerous transactions. In view of these disadvantages, John Due opined that, 'On administrative as well as economic and equity grounds the objections to the multi-stage form are so great as to suggest its complete rejection, regardless of circumstances' [Due, 1959, p. 417].

### *Single-Point Sales Tax*

A single-point sales tax applies to one stage, either at the manufacturing, or the wholesale, or the retail level. At the manufacturing level, sales tax applies to the sale by the manufacturer of finished product and is similar to excise duty. At

the wholesale level, the tax applies to the last wholesale transaction, i.e., purchase by the retailer. The retail sales tax applies to the final sale which means sale to the consumer.

The main advantage of single-point sales tax is that it does not discriminate against non-integrated firms as does a multi-point sales tax. It, thus, discourages vertical integration and promotes horizontal integration. As regards the stage of its imposition, the retail stage is considered the most satisfactory due to the following reasons: (i) Sales tax at the retail stage is collected when final sale to the consumer takes place. It, thus, avoids what the economists call 'cascading' or 'pyramiding' effect of a tax. The contention is that middlemen apply fixed percentage mark-ups to purchase prices and if the purchase prices include taxes (as is the case if sales tax is imposed at manufacturer's, or wholesaler's level), the mark-ups will be applicable to the tax component of the purchase prices as well, a situation which must be avoided in consumers' interest. (ii) A given revenue can be realised by applying a lower tax rate at the retail stage as compared to other stages because the margins of all middlemen are included at the final stage of sale, meaning thereby the enlargement of the tax base at the retail stage. (iii) The desired change in the ratio of tax to consumer expenditure can be achieved more effectively in case of retail-stage sales tax. This will be difficult at 'other stages' because the margins of dealers on various goods, besides being applied to the tax component of the purchase prices, may differ significantly. (iv) Sales tax at the retail stage can be shown separately from the price and thus made known to the purchaser, increasing tax consciousness among the taxpayers. (v) Expected changes in the rates of retail sales tax do not lead to changes in inventory position of the firms. Anticipated changes in the rates of sales tax at 'other stages' may influence



inventory decisions of the firms causing dislocation in trade circles.

However, retail-stage sales tax has its own problems, the chief being the large number of taxpayers in the form of small shopkeepers and scattered retail outlets. In developing countries, the problem of tax administration is more acute in view of widespread illiteracy, lack of monetisation, and poor accounting practices. From the administrative viewpoint, this form of taxation is costlier and cumbersome, offering ample scope for tax evasion and corruption.

Sales tax at manufacturing, or wholesale stage, is administratively preferable because the number of taxpayers is small and readily identifiable. However, the problem of 'cascading' will reappear. In fact, the farther we move from the retail level, the more serious the problem of 'cascading' becomes. In short, the problem boils down to a trade-off between economic rationale and administrative efficiency. The relative weightage to competing objectives depends on political judgement and the economic circumstances under which the sales tax system has to operate.

#### PRE-CONSTITUTION DEVELOPMENTS

Entry 48 of List II of the Seventh Schedule of the Government of India Act, 1935 vested in the Provinces the power to levy 'taxes on the sale of goods and on advertisements'.

The Government of Central Provinces (now more or less coterminous with Madhya Pradesh) was the first to take advantage of this provision when it levied a retail sales tax on motor spirit and lubricants in 1938. This so-called 'petrol tax' was selective sales tax imposed through the Central Provinces and Berar Sales of Motor Spirit and Lubrication Taxation Act, 1938.

In 1939, Madras levied a general multi-point sales tax through the Madras General Sales Tax Act, 1939. The tax levied at the rate of half per cent was ostensibly meant to compensate the loss of revenue resulting from the policy of prohibition.

#### Initial Legal Hurdles

From its very inception, sales tax has been a controversial levy embroiled in legal wranglings. Thus, soon after its enactment, the Central Provinces Act referred above was challenged by the Central Government as unconstitutional. It may be recalled that Entry 45 of List II of the Seventh Schedule of the Government of India Act, 1935 had given the Central Government the power to levy excise on tobacco and other goods manufactured or produced in India. Hence, the Central Government maintained that sales tax on motor spirit and lubricants by the Central Provinces was *ultra vires* because the power to levy excise on such products belonged to it (Central Government). Deciding in favour of the Provincial Government, the Federal Court observed that such taxes were in no way connected with the production or manufacture of goods, but were imposed on their sale [Magler, 1970, p. 150].

In another legal battle, the Central Government contested the Madras General Sales Tax Act, 1939 referred above. Being a multi-point sales tax, it covered sales by manufacturers also which was challenged by the Central Government. Once again, the Federal Court decided in favour of the Provincial Government and held that it had the power to tax sales of every kind, including sales by a manufacturer or producer [Mahler, 1970, p. 150].

The above two judicial pronouncements made it clear that Provinces were competent to tax sales of *any commodity* and *at any stage*. In other words, a clear-cut distinction was drawn between the two, excise to be a tax on the act of production or manufacture, and the sales tax to be a levy on the act of sale.

With the initial legal squabbles concluding, sales tax gained rapid popularity among the Provinces from the beginning of the 1940s. Bengal adopted a single-point general sales tax levied at retail level in 1941. In the same year, Punjab introduced a general sales tax broadly based on the multi-point model of Madras. A general sales tax on the lines of single-point system of Bengal was introduced by Bihar in 1944



and by Bombay in 1946. Other Provinces followed suit and by 1948 all of them were operating sales tax in one form or the other with the notable exception of Jammu and Kashmir. This State was the last to introduce sales tax in 1962.

### *'Beggar-My-Neighbour' Policies*

There was no provision in the Government of India Act, 1935 to restrict or prohibit the Provinces from levying sales tax on inter-State transactions. In other words, the Act did not require the Provinces to levy sales tax only on those transactions which exclusively took place in their respective territories.

Taking advantage of this loophole in the Act, almost all the Provincial legislatures enacted sales tax laws which enabled them to tax goods exported from one State to another. These practices led to multiple taxation of the same transaction by different Provinces. As one scholar remarked, 'Perhaps, the most important problem relating to sales taxation in the pre-Constitution period was the taxation of inter-State sales. All the Provinces, with the exception of West Bengal, were collecting sales tax on goods being sent to other Provinces and were, in effect, indulging in 'beggar-my-neighbour' policies' [Mahler, 1970, p. 151].

In order to sort out these problems and to ensure all-India co-ordination, the Government of India convened a conference of the Finance Ministers of States in October 1948. At this conference attempts were made to achieve some degree of uniformity in the taxation of inter-State sales. However, these attempts failed in view of widespread disagreement among the States. In particular, States which produced important raw materials/manufactured goods were opposed to changes that would result in the exclusion of inter-State trade from the purview of their sales tax laws.

In short, the system of sales tax on the eve of the Constitution was arbitrary and bereft of national considerations.

### CONSTITUTION OF INDIA AND THE PROVISIONS FOR THE REGULATION OF TAXATION OF INTER-STATE SALES

The problems relating to taxation of inter-State sales were considered by the Drafting Committee of the Constituent Assembly. It proposed incorporation of provisions in the Constitution restricting the powers of the State Governments in respect of the levy of sales tax in the course of foreign trade, inter-State trade, and on essential commodities. In spite of opposition from some States, these provisions were finally incorporated in the Constitution as Article 286 (described below).

Under Entry 54 of List II (State List) of the Seventh Schedule of the Constitution, the States were given the power to levy 'a tax on sales or purchases of goods other than newspapers'. This provision was quite similar to Entry 48 of List II of the Seventh Schedule of the Government of India Act, 1935. However, under the Constitution, the States' power to levy sales tax was subject to a number of restrictions. These restrictions as mentioned in Article 286 of the Constitution were the following:

(1) No law of a State shall impose a tax on the sale or purchase of goods where such sale or purchase takes place: (a) outside the State; or (b) in the course of the import of goods into, or export of goods out of, the territory of India.

(2) Except in so far as Parliament may by law otherwise provide, no law of a State shall impose a tax on the sale or purchase of any goods where such sale or purchase takes place in the course of inter-State trade or commerce.

(3) No law made by the Legislature of a State imposing a tax on the sale or purchase of any such goods as have been declared by Parliament by law to be essential for the life of the community shall have effect unless it has been reserved for the consideration of the President and has received his assent.

In simple words, the States were prevented from taxing the following transactions: (a) Sales or purchases in the course of foreign trade; (b) sales of goods delivered in another State for consumption purpose; and (c) sales in the course of inter-State trade and commerce. Furthermore, the

power of States to levy the tax on commodities declared to be 'essential' by Parliament was made subject to the prior approval of the President.

#### *Consequences of Constitutional Restrictions on Sales Taxation*

The first restriction resulted in considerable loss of revenue to States which were levying sales tax on exports. The main losers in this category were Bombay, Bihar, Madhya Pradesh, Orissa, and Assam. Nevertheless, this was the least controversial provision of Article 286.

The second and third restrictions, the benefits of which applied equally to registered dealers, unregistered dealers and consumers, led to large scale evasion and avoidance of tax and hence loss of revenue to States in general. The Taxation Enquiry Commission, 1953-54, observed: 'Traders in one State started to sell direct to unregistered dealers and consumers in another. Similarly, consumers of valuable commodities tried to get these from dealers in another State rather than buy the articles from their local dealers. The practice grew for sales of goods within a State itself to be shown in the books of accounts as having been made to fictitious dealers outside the State and the goods having then been re-sold by those dealers to consumers within the State. For valuable commodities like motor vehicles, jewellery, watches, etc., this practice became very common. On transactions that could be shown to be in the course of inter-State trade, the "exporting" State was prohibited under Article 286 from levying the sales tax; and if the goods delivered as a result of these transactions were shown to be received by individual consumers or unregistered dealers neither could any tax be levied on them by the "importing" State. Thus, many of these transactions escaped sales tax altogether' [Matthai, 1953-54, Vol. III, Pp. 25-26].

The loss of revenue was more for States with single-point system as compared to States having multi-point sales taxation. This was so because the restriction was not applicable to sales in the State prior to the last point of sale for export to

another State.

The constitutional restrictions led to uneconomic diversion of trade and production centres. The problems which the constitutional provisions sought to solve got further compounded albeit with a different nature. To quote, 'The constitutional restrictions on sales taxation greatly increased the scope for evasion. While the problem before the Constitution had been multiple taxation (by different States) on the same act of inter-State sale, the problem after the Constitution was that inter-State sales frequently escaped taxation altogether' [Mahler, 1970, p. 154].

#### *Essential Goods Act, 1952*

As already noted, in addition to the above restrictions, Article 286 also prevented the States from levying tax on sales or purchases of goods declared by Parliament to be essential for the life of the community, except with the previous assent of the President. For this purpose, Parliament enacted the Essential Goods (Declaration and Regulation of Tax on Sale or Purchase) Act, 1952, and various commodities were declared as essential including cereals and pulses, fresh and dried fruits, fresh milk, meat, fish, salt, hides and skins, iron and steel, coal, fertilisers, petroleum products, books, etc. As to the desirable purpose of the Act, the Taxation Enquiry Commission, 1953-54 noted, 'It is obvious that the object of restricting the power of the States to levy a tax on the sale or purchase of "essential goods" is to achieve some degree of uniformity in the tax burden on those goods, and not necessarily or in all cases to eliminate altogether the sales tax on such goods. When the Bombay Government sought the assent of the President to tax some of the 'essential goods' under their new multi-point tax system, the assent was given on condition that the tax burden on these goods should not in any event exceed the previous tax burden under the single-point system. This seems to indicate that the policy underlying the restriction is one of freezing the existing tax levied on these goods and of ensuring that new proposals to tax them are



confined within reasonable limits' [Matthai, 1953-54, Vol. III, p. 29].

In spite of its desirable objectives, the enactment of the Essential Goods Act, 1952 led to various problems and criticism from some State Governments. Since the legislation was not retrospective, the States which had been levying sales tax on 'essential goods' prior to the passage of the Essential Goods Act continued to levy the tax. However, those States which sought to levy the tax after the passage of the Act had to obtain the consent of the President. This evoked sharp resentment among the concerned State Governments.

The resentment among the States was further fuelled by the fact that the Central Government itself was levying relatively high rates of excise/customs duties on some of the so-called 'essential goods'.

#### CONSTITUTION (SIXTH AMENDMENT) ACT, 1956

In view of the problems arising from constitutional restrictions on the taxation of inter-State sales, the Taxation Enquiry Commission, 1953-54 recommended as follows: 'In essence, the sales tax must continue to be a State tax. However, power and responsibility of the State must end, and that of the Union begin, when the sales tax of one State impinges administratively on the dealers and fiscally on the consumers of another State. Inter-State sales tax should be the concern of the Union' [Matthai, 1953-54, Vol. III, p. 519].

Consequently, the Constitution was amended by the Sixth Amendment Act of 1956. Under this Amendment, the Parliament was empowered to impose 'taxes on the sale or purchase of goods other than newspapers, where such sale or purchase takes place in the course of inter-State trade or commerce'. This new provision in the Constitution was made by inserting Entry 92A in List I (Union List) of the Seventh Schedule. Simultaneously, Entry 54 of List II (State List) was made subject to the provisions of new Entry 92A of List I. Also, Article 269 of the Constitution was amended which added a new clause (1) (g) which permitted taxes on the sale or purchase of

goods in the course of inter-State trade to be levied and collected by the Government of India but assigned to the States.<sup>1</sup> Again, clauses (2) and (3) of Article 286 of the unamended Constitution were substituted by new clauses to make it read as follows:

- (1) No law of a State shall impose or authorise the imposition of a tax on the sale or purchase of goods where such sale or purchase takes place -
  - (a) outside the State; or (b) in the course of the import of the goods into or export of the goods out of the territory of India.
- (2) Parliament may by law formulate principles for determining when a sale or purchase of goods takes place in any of the ways mentioned in clause (1).
- (3) Any law of a State shall, in so far as it imposes or authorises the imposition of a tax on the sale or purchase of goods declared by Parliament by law to be of special importance in inter-State trade or commerce, be subject to such restrictions and conditions in regard to the system of levy, rates and other incidents of the tax as Parliament may by law specify.

The new Article 286(2) gave Parliament the powers to define a sale outside a State. The new Article 286(3) is different from the old 286(3) in the following respect. In the old provision, Parliament had the authority to restrict State taxation of commodities declared by Parliament to be 'essential for the life of the community'. In the new provision, Parliament is empowered to restrict State taxation of goods declared to be of special importance in inter-State trade only.

Clause (3) of Article 286 was further amended by the Constitution (Forty-sixth Amendment) Act, 1982. In its present form it is as follows:

Any law of a State shall, in so far as it imposes, or authorises the imposition of (a) a tax on the sale or purchase of goods declared by Parliament by law to be of special importance in inter-State trade or commerce; or (b) a tax on the sale or purchase of goods, being a tax of the nature referred to in sub-clause (b), sub-clause (c) or sub-clause (d) of clause (29-A) of Article 366, be subject to such

restrictions and conditions in regard to the system of levy, rates and other incidents of the tax as Parliament may by law specify.

#### THE CENTRAL SALES TAX ACT, 1956

Consequent upon the enactment of the Constitution (Sixth Amendment) Act, 1956, the Central Sales Tax (CST) Act was passed in 1956. The following three main objectives of the CST Act were stated in the Preamble: (1) To formulate principles for determining when a sale or purchase of goods takes place in the course of inter-State trade or in the course of import into or export from India. (2) To provide for the levy, collection, and distribution of taxes on sale of goods in the course of inter-State trade or commerce. (3) To declare certain goods to be of special importance in inter-State trade and specify the restrictions to which State laws imposing taxes on the sale and purchase of such goods of special importance shall be subject.

#### Main Provisions of CST Act

The regulations contained in the CST Act provide, *inter alia*, for a degree of uniformity by prescribing a maximum rate of sales tax on certain goods considered important for the whole country. According to section 3 of the CST Act, a sale or purchase of goods is deemed to take place in the course of inter-State trade if it (a) occasions the movement of goods from one State to another, or (b) is effected by a transfer of documents of title to the goods during their movement from one State to another.

Section 14 of the Act declares certain goods to be of special importance in inter-State trade and commerce. These are: coal, cereals, cotton, cotton yarn, cotton fabrics, crude oil, hides and skins, iron and steel, jute, oilseeds, pulses, rayon and artificial silk fabrics, sugar, tobacco, and woollen fabrics. The list of 'declared goods' originally covered by the Act in 1956 was expanded twice, once in 1957 to include textiles, sugar, and tobacco and again in 1976 to include cereals (like wheat, paddy, rice, etc.), crude oil, and pulses.

Section 15 of the Act lays down the rate structure. The rates are different depending upon the classes of goods and the status of the person to whom the goods are sold. Thus, goods are either 'declared goods' (goods of special importance) or 'non-declared goods' while a person may be a registered or a non-registered dealer. Based on these classifications, the rates of sales tax are prescribed by the Central Government though the tax is administered (i.e., assessed, collected and appropriated) by the State Governments by virtue of the powers delegated to them by the Central Government under Article 258(1) of the Constitution.

In 1956, when the Central Sales Tax Act was passed, the rate of sales tax was fixed at 1 per cent. Subsequently, it was raised to 2 per cent, 3 per cent, and 4 per cent in 1958, 1966, and 1975, respectively. The maximum prescribed rate of sales tax on 'declared goods' inside a State is 4 per cent of the sale price and is not leviable at more than one stage. Thus, although sales tax on intrastate sales is levied by the States, taxation of intrastate sales of 'declared goods' (goods of special importance) is subject to certain restrictions in terms of the nature of the levy (not to be levied at more than one stage) and the rate of tax (not more than 4 per cent).

In the case of inter-State sale of such goods to registered dealers, the rate of tax is the same as applicable to the sale of such goods inside the exporting States. In respect of sale of 'declared goods' to non-registered dealers (including consumers) the CST is chargeable at twice the rate applicable to the same goods inside the State, i.e., 8 per cent. Where 'non-declared' goods are sold in the course of inter-State trade to a registered dealer the ceiling rate is 4 per cent<sup>2</sup> or the rate applicable to internal sales of the concerned goods, whichever is lower.<sup>3</sup> However, on inter-State sale of non-declared goods to non-registered dealers, the rate of CST is 10 per cent or the rate applicable to the sale of such goods inside the exporting State, whichever is higher.<sup>4</sup>

The Act further specifies that when a sales tax has been levied inside a State on any declared goods and such goods are sold in the course of



inter-State trade, the tax so levied shall be refunded. Provision also exists that goods which are generally and unconditionally exempt from the sales tax within a State will also be exempt from CST in the course of inter-State trade.

#### *Working of the CST Act*

It is clear as to why some kind of Central control is necessary on sales tax for larger national interest. Had Punjab and Haryana been free to levy sales tax on foodgrains at will, the people of food deficit States would have suffered. Similarly, uncontrolled sales tax levies by West Bengal and Bihar on iron and steel and on coal would have impeded the growth of engineering industry in Gujarat and Maharashtra.

The CST Act authorises a State to tax residents of other States. Lest this power should be misused to export undue tax burden to other States, the original scheme devised in 1956 kept the rate of CST low at 1 per cent ensuring some reasonable revenue for the exporting States. However, over the years the rate of CST has been raised by stages to 4 per cent. This trend has benefited industrially advanced States (Maharashtra, Gujarat, Tamil Nadu and West Bengal) at the cost of industrially backward States. Since manufactured goods are the main items of inter-State trade, the developed States are able to export a part of their taxation to other States. In effect, it amounts to transfer of financial resources from poorer States to well off States, much against the declared objective of regional balanced development and equitable distribution of resources among the States. Moreover, the high rate of CST hinders the free flow of trade and commerce within the country.

It may be suggested that the rate of CST should be reduced to the original level of 1 per cent to safeguard the interest of poorer States. Furthermore, the Central Government should declare some more inputs as goods of special importance in inter-State trade to restrict the power of the States to tax such goods. However, these suggestions have met with stiff resistance from most State Governments. At the New Delhi Conference of Chief Ministers held on September 16-17,

1980, there was a unanimous opinion that the rate of CST should not be brought down from 4 per cent to 1 per cent. However, it was agreed to constitute a panel of Chief Ministers to consider, *inter alia*, additions to the list of 'declared goods'. The Conference also expressed unanimity over the need for uniform sales tax laws in the country because variants of the sales tax pose problems for the collecting authorities as well as for the taxpayers. The Chief Ministers' Conference decided to request the Law Commission to undertake on a high priority basis the drafting of a model sales tax law for consideration by the States.

#### ADDITIONAL DUTIES OF EXCISE (GOODS OF SPECIAL IMPORTANCE) ACT, 1957

Another landmark in the evolution of sales tax in India was the year 1956 when, following a voluntary agreement between the Centre and the States at a meeting of the National Development Council (NDC) held in December, 1956, it was decided to replace sales tax on textiles, tobacco and sugar by additional duties of excise and to distribute revenues derived therefrom among the States. The agreement also provided that the share accruing to each State shall not be in any case less than the revenue realised from the levy of sales tax on these goods for the financial year 1956-57 in that State. The Council's decision was implemented through the Additional Duties of Excise (Goods of Special Importance) Act, 1957 the first schedule of which prescribed the rates of additional duties of excise and the second schedule dealt with the scheme of the distribution of the net proceeds among the States.

The Act does not debar States from the levy of sales tax on the specified commodities, but it does provide that if, in any year, any State levies and collects a tax on the sale or purchase of such commodities, no sum shall be paid to that State in that year by way of share out of the net proceeds of the additional duties of excise, unless the Central Government by special order decides otherwise. The commodities covered under the scheme (textiles, tobacco and sugar) were

declared goods of special importance in inter-State trade so that no State could find it worthwhile to opt out of the voluntary agreement not to impose sales tax on these goods.<sup>5</sup> The revenue derived from additional duties of excise, levied and collected by the Centre, is distributed among the States in accordance with the formula prescribed by the Finance Commission. The Fourth Finance Commission described it as 'tax rental arrangement'.<sup>6</sup>

#### *Rationale of the Scheme*

The scheme of additional duties of excise in lieu of sales tax has the following advantages: (i) It minimises tax evasion by levying the tax at first point and saving industry, trade, and consumers from the administrative complexities involved in the collection and payment of sales tax. (ii) It helps in maintaining uniformity in the prices of widely consumed goods throughout the country. (iii) Such an arrangement contributes to the development of an integrated market by facilitating movement of goods across State borders. (iv) Rationalization of commodity taxation at the national level becomes easy. (v) Cost of collection is reduced.

#### *Views of the State Governments*

The scheme of additional duties of excise in lieu of sales tax has been in force for the last 38 years. While the business community has demanded the extension of this scheme to other commodities, the States have generally remained disinclined in this regard. The mistrust between the Centre and the States regarding the operation of this scheme by the Central Government is an irritant in Centre-State relations.

Generally, the States have argued that (a) sales tax is the only elastic source of revenue available to them and in view of its regional applicability it is also the only effective instrument for shaping their economic policies; (b) replacement of it by a Central levy will encroach on their constitutional rights leading to erosion of their financial autonomy; and (c) if taxes are levied and collected

by a State itself then it is more conscious of its responsibility towards the taxpayers. Subventions from the Centre may lead to reckless spending causing fiscal indiscipline.

As regards the working of the existing scheme, the dissatisfaction of the State Governments is borne out of their belief that revenue potential of additional duties of excise has not been fully exploited by the Centre. Their complaint is that the growth of revenue from additional excise duties on textiles, sugar and tobacco, lags behind the growth in revenue from basic excise duties on the same commodities. The States complain that once sales tax on the three commodities was replaced by additional excise duties, the Centre did not feel the need for consultation with the States for reviewing the working of the scheme. They claim that the rate of growth of their sales tax revenue is much higher than the rate of growth in the yield from additional excise duties.

#### *Decisions of the National Development Council*

Following the complaints of the States, the whole issue was reconsidered by the National Development Council in its meeting held on December 28, 1970. The Council decided to continue the scheme with the following conditions: (a) that the incidence of additional duties would be stepped up to 10.8 per cent of the value of clearances within a period of two or three years, (b) that a ratio of 2:1 between basic and additional excise duties would be achieved and maintained, and (c) that specific duties would be converted into *ad valorem* duties except in regard to unmanufactured tobacco. It was also agreed that a Standing Review Committee consisting of representatives of the Central and the State Governments with Economic Adviser, Planning Commission, as convener, would be set up and the same would meet at least once a year to review the working of the new arrangement and make such recommendations as may be necessary for its further improvement.

Let us examine to what extent the various



clauses of the agreement reached in 1970 have been implemented. As a follow up action, specific duties were replaced by *ad valorem* rates and significant enhancements were made in additional excise duties in the Central budgets for the three consecutive years 1971-72 to 1973-74. The Standing Review Committee met for the first time in February 1981 and appointed a sub-committee which recommended that the incidence of 10.8 per cent should be achieved in three stages: 8.5 per cent by 1984-85; 9.75 per cent by 1987-88; and 10.8 per cent by 1989-90. The Ninth Finance Commission was informed by the Union Finance Ministry that the incidence achieved by the end

of 1988-89 was 10.7 per cent. The Commission hoped that the committed level of 10.8 per cent would be actually achieved by the end of 1989-90. In a significant move, the Commission recommended that during its award period (1990-95), if in any year the incidence of additional excise duties falls short of the level of 10.8 per cent of the value of clearances, the shortfall should be made good by the Centre by providing equivalent amount by way of grant-in-aid to be distributed amongst the States in the same manner as recommended for sharing the proceeds of additional excise duties [Finance Commission, 1989, Second Report, p. 34].

TABLE 1. RATIO BETWEEN BASIC AND ADDITIONAL DUTIES OF EXCISE ON SUGAR, TEXTILES AND TOBACCO, 1971-72 TO 1994-95

Year	Sugar	Textiles	Tobacco	All Three Commodities
1971-72	4.03:1	2.65:1	5.34:1	4.17:1
1972-73	3.84:1	2.00:1	3.62:1	3.24:1
1973-74	3.57:1	2.32:1	2.74:1	2.84:1
1974-75	3.64:1	2.31:1	2.71:1	2.82:1
1975-76	4.16:1	1.35:1	2.82:1	2.68:1
1976-77	3.98:1	1.12:1	2.93:1	2.55:1
1977-78	3.35:1	1.53:1	2.91:1	2.61:1
1978-79	2.00:1	0.84:1	3.28:1	2.13:1
1979-80	2.23:1	1.04:1	3.36:1	2.39:1
1980-81	1.67:1	0.96:1	3.49:1	2.21:1
1981-82	1.59:1	0.82:1	2.98:1	1.94:1
1982-83	1.57:1	0.75:1	2.72:1	1.79:1
1983-84	1.19:1	0.48:1	2.58:1	1.48:1
1984-85	0.88:1	0.45:1	1.99:1	1.28:1
1985-86	0.85:1	0.33:1	1.89:1	1.19:1
1986-87	0.86:1	0.26:1	2.18:1	1.19:1
1987-88	0.83:1	0.18:1	2.29:1	1.23:1
1988-89	0.82:1	0.16:1	2.47:1	1.23:1
1989-90	0.87:1	0.16:1	2.28:1	1.22:1
1990-91	0.88:1	0.06:1	2.27:1	1.25:1
1991-92	0.90:1	0.06:1	2.28:1	1.17:1
1992-93	0.91:1	0.06:1	2.29:1	1.15:1
1993-94 (R.E.)	0.89:1	0.05:1	2.23:1	1.07:1
1994-95 (B.E.)	0.89:1	0.05:1	2.23:1	1.04:1

Source: Calculated from data collected from Government of India, Ministry of Finance, *Explanatory Memorandum on the Budget of the Central Government*; and *Receipts Budget* (various years).

As regards the ratio between basic excises and additional excises, commodity-wise data are presented in Table 1. The ratio between basic and additional duties on sugar declined from 4.03:1 in 1971-72 to 1.67:1 in 1980-81, and was estimated at 0.89:1 in the budget for 1994-95. In the case of textiles, the ratio fell from 2.65:1 in 1971-72 to 0.96:1 in 1980-81 and was estimated at 0.05:1 in the 1994-95 budget. Similarly, for tobacco the ratio declined from 5.34:1 in 1971-72 to 3.49:1 in 1980-81 and was estimated at 2.23:1 in the 1994-95 budget. The overall ratio (the three commodities taken together) declined from 4.17:1 in 1971-72 to 2.21:1 in 1980-81, and was estimated at 1.04:1 in the 1994-95 budget. Thus, by fulfilling its obligation, the Centre achieved the 2:1 ratio by 1981-82, and in fact the ratio has further declined, rather sharply, since then. It may be recalled that in the early years of the operation of the scheme, the overall ratio tilted heavily in favour of the Centre. For example, in 1960-61, the basic excise duty collected from the three commodities was Rs 146.8 crore while additional duty grossed Rs 33.6 crore, giving a ratio of 4.5:1.

Thus, the statistical evidence suggests that the Central Government, though slow in implementing the agreement reached between it and the States, has ultimately honoured the promises made. However, the slow implementation caused resentment among the States.

#### *Role of the Finance Commission*

The Finance Commission comes into picture for the purpose of determining the principles of distribution of the net proceeds of additional duties of excise among the States.

*Guaranteed Amount:* The first issue before the Finance Commission is to determine the yield in 1956-57 from sales tax on the commodities subject to additional excise duties for the purpose of guaranteeing to the States concerned the amount so determined. The Second Finance Commission, which was the first to deal with this problem, adopted elaborate procedures for working out estimates of yield (i.e., the guaranteed amount for the year 1956-57). These were primarily based on

consumption estimates and figures of collection of sales tax obtained from each State for the years 1954-55 to 1956-57. The later Finance Commissions did not consider it feasible, in view of the lapse of time, to reassess the likely yield in 1956-57 of sales tax to redetermine the guaranteed amount and therefore accepted the Second Finance Commission's estimates with adjustments whenever necessary.<sup>7</sup>

*Procedure for Guaranteed Amount:* The second issue for consideration by the Finance Commission is whether the guaranteed amounts should first be set apart from the net proceeds and the balance then distributed among the States or to distribute the entire net proceeds on appropriate principles subject to the overriding proviso that no State should get less than the guaranteed amount. The Second, Third, Fourth and Fifth Finance Commissions preferred the first alternative thinking that unless the guaranteed amounts were first set apart and the balance alone distributed among the States, there was the risk of the share of some of the States falling below the guaranteed amount. However, the Sixth and the subsequent Finance Commissions did not feel the need to set apart the guaranteed amount as there was no risk of the share of any State falling short of the guaranteed amount. In adopting the second alternative, i.e., distributing the entire net proceeds on some appropriate principles, the Sixth and the Seventh Finance Commissions were guided by an underlying philosophy to help the weaker States. To the question whether the guaranteed amount should first be set apart the Seventh Finance Commission remarked, 'If that were done, there is no doubt that some States would receive in the period covered by our Report shares slightly larger than the shares they would receive if the guaranteed amounts were not so set apart. While it is true that under the NDC resolution earlier agreed to, a State is entitled to have a share which should not be less than the guaranteed amount, the agreement does not assure to any State any extra benefit (that) it would receive were the guaranteed amount first set apart' [Finance Commission, 1978, p. 59].

Thus, taking a technical view of the matter, the



Seventh Finance Commission applied the principle of distribution to the entire net proceeds from additional excise duties. The Eighth Finance Commission endorsed this view and followed suit.

*Basis of Distribution:* The third issue relates to the determination of the basis of distribution of additional excise duties among the States. The assurance of the guaranteed amounts in the original agreement was an indication of the logic that in the distribution of the net proceeds the principle of compensation was to be followed. In other words, each State should be enabled to get almost the same amount as it would have got, had sales taxes on these commodities been in operation with the same order of incidence as the additional excise duties. This view, which has generally been accepted by the Finance Commissions, precludes other considerations like needs of the State, relative backwardness, etc., which are relevant in relation to allocation of other Central taxes.

For proper implementation of the compensation principle, it is widely recognised that State-wise figures of consumption of the commodities on which additional excise duties are levied accord the best reflection of the potential loss of revenue sustained by States' surrender of authority to levy sales tax on them. However, Finance Commissions have differed in adopting methods to assess relative levels of consumption of these commodities in different States. The divergence of opinion on this account has been mainly due to paucity of reliable data on state-wise consumption of these commodities. Thus, the Second Finance Commission recommended the distribution of additional excise duties on the basis of the then available consumption figures with population as a correctional factor. The Third Finance Commission distributed the collections in excess of guaranteed amounts partly on the basis of the percentage increase in the collection of sales tax in each State since the year 1957-58 and partly on the basis of population. It did not, however, indicate the relative weightage given to these factors. The Fourth Finance Commission felt that figures of collection of all sales taxes in

a State were a more direct indicator of the contribution made by each State to the divisible surplus than population. Abandoning the population factor altogether, it recommended the distribution of the balance over the total of guaranteed amounts on the basis of the proportion of sales tax revenue realised in each State to the total sales tax collections in all the States taken together. The Fifth Finance Commission reverted back to the Third Finance Commission's formula and recommended distribution of additional excise duties giving equal weightage to both sales tax collections and population.

The Sixth Finance Commission rejected sales tax collections outright as possible indirect indicator of the level of consumption of textiles, sugar and tobacco in different States. It observed, 'Sales tax is applicable to a wide range of commodities comprising luxuries, semi-luxuries, raw materials, intermediate goods and the like. Sales tax revenue derived from these commodities may be a measure of the tax effort of the State Government but it does not provide even an indirect clue to the levels of consumption of textiles, sugar, and tobacco on which additional excise duties are being levied in lieu of sales tax' [Finance Commission, 1973, p. 20].

Alternatively, the Sixth Finance Commission preferred data of State Domestic Product (SDP) as indicator of the likely consumption of these commodities in view of the close relationship between income and consumption. However, with regard to coarser varieties of cloth, the Commission felt that the consumption was more likely to depend on population (the commodity being a necessity) than on State Domestic Product. With such considerations in mind, the Commission recommended the distribution of the entire net proceeds of additional duties of excise on the basis of population, State Domestic Product at State current prices, and production in the ratio of 70:20:10.

The Seventh Finance Commission examined in detail the available statistics of State-wise consumption of the commodities to which additional excise duties are applicable. In particular, it studied the suitability of household consumer

expenditure data of the National Sample Survey (NSS) for adoption as a measure of the consumption of these articles in each State. However, in view of the various limitations of NSS data,<sup>8</sup> the Commission did not find it proper to use these data for estimating the consumption in each State of the articles subject to additional excise duties.

Making a departure from the approach of the earlier Finance Commissions, the Seventh Finance Commission adopted different formulae for distribution of additional excise duties on different commodities. In the case of sugar, it recommended the distribution of the net proceeds of additional duties among the States in proportion to the despatches of sugar to each of the States averaged for three years ending with 1976-77. Statistics of despatches of sugar to each State, obtained from the Department of Food of the Government of India, were taken as a fair approximation of consumption of sugar in each State. In the case of textiles and tobacco, the average per capita State Domestic Product of each State for the 3 years ending 1975-76 was multiplied by the population of the State according to the 1971 Census and the percentage shares of this product of each State in the corresponding all-States' total figure were worked out. It is pertinent to note that the Seventh Finance Commission made a specific suggestion to the Central Government regarding collection of suitable statistics for reliable estimates of consumption of these articles in each State for the benefit of future Finance Commissions.

The Eighth Finance Commission also could not obtain reliable estimates of consumption of these commodities. It, therefore, recommended the distribution of additional duties of excise on all the three commodities (sugar, textiles and tobacco) by giving equal weightage to State Domestic Product and population.

The Ninth Finance Commission maintained that since sales tax itself is a tax on consumption, the shares of various States in additional duties of excise should correspond to their shares in the consumption of these commodities. It observed, 'The fact that the proceeds of Additional Excise Duties are distributed only in pursuance of a tax

rental arrangement between the Centre and the States (which has its origin in the National Development Council meeting in 1956) would clearly imply that this distribution cannot be treated as devolution or grant-in-aid in the sense that these terms are normally understood. The terms of reference would, therefore, not bind us to use the 1971 population for computing the States' share of Additional Excise Duties. But for the tax rental arrangement, the States would have been collecting Sales Tax on the current consumption of the relevant commodities. Since population is being used only as a proxy for consumption along with SDP, we consider it as only logical that any criterion which links the shares of the States nearest to the consumption of the relevant items in the individual States should be preferred' [Finance Commission, 1989, p. 20].

*Recommendations of the Expert Committee on Replacement of Sales Tax by Additional Excise Duty, 1983*

As already noted, sales tax on textiles, tobacco and sugar was replaced by additional duties of excise in 1957. The scheme of additional excise duties was proposed to be extended to some more commodities in 1980. At a conference of Chief Ministers convened by the Centre on September 16-17, 1980, it was resolved to bring vanaspati and life-saving drugs under additional excise duties in lieu of sales tax. It was also decided to constitute a committee of Chief Ministers to consider what other items could be added to the list for additional excise duties. However, the non-Congress (I) States, viz., Kerala, Tamil Nadu, Tripura, and West Bengal did not agree with the resolution passed at the Chief Ministers Conference.

The matter was further examined at another conference of Chief Ministers held in February 1981 which recommended the appointment of an expert committee by the Central Government to look into this matter. The Expert Committee under the Chairmanship of Mr. Kamalapati Tripathi submitted its report in January 1983. It recommended the replacement of sales tax by additional excise duty on vanaspati, drugs and

medicines, cement, paper and paper board, and petroleum products. The recommendations were considered in a conference of Chief Ministers held on November 2, 1983. However, the six Chief Ministers of the non-Congress (I) States, viz., Andhra Pradesh, Jammu and Kashmir, Karnataka, Tamil Nadu, Tripura, and West Bengal opposed the Centre's initiative to implement the recommendations. The recommendations of the Tripathi Committee were further discussed at a conference of Chief Ministers held in New Delhi on February 9-10, 1989. Unfortunately, no progress could be made in this regard and the matter is still hanging fire.

The opposition of non-Congress (I) States was based on the belief that implementation of the scheme would erode their revenue position. However, a close perusal of the recommendations of Tripathi Committee suggests that it has evolved elaborate formulae for protecting the financial interests of the States. In the case of three commodities, namely, paper and paper board, vanaspati, and drugs and medicines, it suggested that the annual rate of growth of the amount to be collected by way of additional excise duty in lieu of sales tax should be related to the future annual growth rate of sales tax revenue of all the States. For petroleum products and cement, which are substantially subject to administered prices, the Committee recommended and worked out linkages between the amount to be collected by way of additional excise duty from year to year and value of consumption on which normal sales tax would be leviable.

In spite of these safeguards, the apprehension of some States that their resource position would be adversely affected reflects their lack of confidence in the Centre in implementing the scheme sincerely. Thus, an important tax reform has become a casualty of the mistrust between the Centre and State Governments. The scheme of additional excise duties in lieu of sales tax has merits of its own. In view of the safeguards provided by the Tripathi Committee and the Ninth Finance Commission, the scheme should not only be retained but extended to other commodities as well.

It is pertinent to mention here that during the first two decades of Independence (1947-67), the

Congress party ruled, with some exceptions, both at the Centre and in the States. This political homogeneity facilitated taxation agreements between the two tiers of the government as, for example, the agreement reached in 1957 regarding substitution of sales tax by excise duties on sugar, textiles and tobacco. Since 1967, the politics of confrontation pursued by different political parties ruling at the Centre and in the States has hindered the process of rationalization and harmonization of commodity taxation. In fact, reform of commodity taxation is closely interwoven with the political process. Unfortunately, the political response to economic logic so far has neither been adequate nor helpful.

#### CONSTITUTION (FORTY SIXTH AMENDMENT) ACT, 1982 AND THE CONSIGNMENT TAX

Consequent upon the Sixth Amendment of the Constitution, the Central Sales Tax (CST) Act was passed in 1956. Section 14 of the Act declares certain goods to be of special importance in inter-State trade, while section 15 of the Act lays down the rate structure.

However, the CST Act left out of its ambit the consignments (or despatches or stock-transfers) from a company to its branch located in a different State. Since no sale is involved, it is called in-house transaction by a company. The loophole has come in handy for unscrupulous parties to evade sales tax by showing virtual sales as consignments from one State to another. By this method, the payment of CST is avoided. Only local sales tax becomes payable. Therefore, through the Constitution (Forty-sixth Amendment) Act, 1982, Parliament was empowered to levy 'taxes on the consignment of goods (whether the consignment is to the person making it or to any other person), where such consignment takes place in the course of inter-State trade or commerce'. This was done by inserting entry 92B in List I of the Seventh Schedule and, simultaneously, amending Article 269 by inserting sub-clause 269(1)(h). Consignment tax is a levy on inter-State transfer of goods.



Ever since then, the States have been pressing the Centre to levy the tax, the net proceeds of which are entirely assignable to States under Article 269. The proposed tax is intended to check avoidance of CST. The Sarkaria Commission on Centre-State Relations, 1988 also impressed upon the Government to 'bring in suitable legislation in this regard without further loss of time' [Sarkaria, 1988, p. 293].

#### *Issues Related to Consignment Tax*

Though the necessary legislation is still to be enacted, industrial and commercial circles have expressed grave concern about the deleterious effects of the impending levy. Trade circles maintain that consignments become necessary in view of seasonal fluctuations in the demand for goods as well as frequent transport bottlenecks. Commercial practices like 'branch transfer' or 'transfer on consignment basis' also help manufacturer-supplier to reduce avoidable costs of holding high levels of inventory.

What will be the impact of consignment tax on prices? What should be the rate of tax? Who shall have the exemption powers? How will it affect the location of industries? How will the proceeds of this tax be shared among the States? These are some of the issues to be sorted out.

The impact of the consignment tax on prices will depend on the rate of the new levy and the commodities covered under its ambit. Since the new levy will be in addition to CST leviable at 4 per cent, it is bound to push up prices. To minimise the inflationary potential, the rate of the new levy may preferably be fixed at a low level of 1 per cent. It may be recalled that in 1956, when the CST Act was passed, the rate was fixed at 1 per cent. However, over the years the rate of CST has been raised by stages to the present level of 4 per cent. Thus, the rate of proposed consignment tax should be low and pegged to that level through constitutional provisions to avoid frequent hikes as in the case of CST.

Furthermore, to lessen the adverse impact on prices, it is necessary to grant exemptions to items of mass consumption which are also daily

necessities of life. To achieve this, it would be desirable that the power to grant exemptions from the proposed levy be concurrently enjoyed by the Centre and the States. The concurrent power of exemption would enable the Centre to ensure uniformity of taxation of goods of national importance, particularly those which are subject to the scheme of administered prices.

The levy of consignment tax may encourage lop-sided industrial development of the country. Producers in States which are self-sufficient with respect to raw materials and the market for goods manufactured out of them will remain unaffected by the consignment tax. Conversely, the entrepreneurs in States which import raw materials from other States and also market their manufactures in other States will be doubly taxed, once on the raw materials and then on the manufactured goods. Under such circumstances, prospective entrepreneurs would be tempted to opt for self-sufficient States to enjoy price advantage on the final product, negating in the process the national policy of regional balanced development.

As regards the sharing of tax proceeds, it is apparent that producer-States, like Maharashtra and Gujarat, would like the proceeds to accrue to the respective States in full. Contrarily, the backward States would prefer to see a higher proportion of the proceeds distributed among them, through the Finance Commission. At a conference of the Chief Ministers held on February 9-10, 1989, it was agreed that 50 per cent of the proceeds of the consignment tax would be retained by the collecting States and the remaining 50 per cent would flow into a divisible pool from which the amount would be distributed among them, in accordance with the formula devised by the Finance Commission. At the same Conference, the Government announced its decision to introduce a Bill in this regard in the monsoon session of Parliament of that year. Since then, nothing has been heard about this legislation.

Sales tax system has already played havoc with internal freedom of industry and trade. Enjoying

their constitutional right, different State Governments levy sales tax on a wide range of commodities at different rates with different procedures and rules for its collection. In a scenario like this, the introduction of consignment tax will further confound the existing confusion about commodity taxation at the State level. The imposition of consignment tax would discourage free movement of goods from one State to another. Restricting movement of goods across State borders through tax practices runs counter to the needs of a growing and diversifying economy. Moreover, in view of the current experiment with Modified Value Added Tax (MODVAT) at the Central level to save industry of the cumulative effects of excise duty, the introduction of consignment tax would hinder the process of rationalisation of commodity taxation. Ideally, the imposition of a consignment tax should be avoided. In case it is unavoidable, a cautious approach is necessary keeping in view the national interest.

PRESENT NATURE AND REVENUE  
SIGNIFICANCE OF SALES TAX

Under the Constitution, the right to levy sales tax belongs to the State Governments. Each State is, therefore, empowered to collect tax on the sale

of goods within its territory according to the rules framed by it. Thus, different State Governments levy sales tax on a wide range of commodities at different rates with diverse procedures and rules for its collection. The Central Government also enters the field in so far as it prescribes the ceiling rate of sales tax on goods in inter-State trade. In the case of three important commodities, viz., textiles, sugar and tobacco, additional duties of excise are imposed in lieu of sales tax, the proceeds of which are distributed among the States.

Different States have adopted different variants of the sales tax due to a number of reasons including administrative convenience, *ad hoc* measures to increase tax revenue, and to attract enterprise in their respective areas. Sales tax in a State may take the form of a single point, double-point and/or multi-point levy. However, single-point is the main type of sales tax imposed on most commodities in all States. In most States a significant part of the sales tax revenue originates from the first-point levy, i.e., at the manufacturer's level. Some States also levy surcharges on sales tax as an *ad hoc* measure to augment their resources.

TABLE 2. TRENDS IN THE RELATIVE SIGNIFICANCE OF SALES TAX IN STATES' OWN TAX REVENUE: SELECTED YEARS  
(Rs crore)

	1950-51	1960-61	1970-71	1980-81	1990-91	1993-94 (B.E.)
A+B Revenue from States' Taxes	221 (100.0)	454 (100.0)	1,527 (100.0)	6,616 (100.0)	30,345 (100.0)	46,284 (100.0)
A. Direct Taxes	81 (36.7)	153 (33.7)	252 (16.5)	685 (10.4)	3,376 (11.1)	4,924 (10.6)
B. Indirect Taxes of which	140 (63.3)	301 (66.2)	1,275 (83.5)	5,931 (89.6)	26,969 (88.9)	41,359 (89.4)
1. Sales Tax	58 (26.1)	158 (34.9)	755 (49.4)	3,887 (58.7)	17,667 (58.2)	27,463 (59.3)

Figures in parentheses indicate the corresponding percentages of the total revenue from States' taxes.

Source: Reserve Bank of India: *Report on Currency and Finance*, Vol. II (various years).

The rate structure of sales tax is further complicated in view of different lists of exemptions/concessions, numerous nominal rate categories, and different administrative procedures in each of the States. These variations have caused disparities in the effective rate of sales tax on similar commodities in different States. Agricultural commodities like cereals and pulses are either exempt or bear low rate of sales tax ranging from 2 to 3 per cent. For most commodities, the rate of single-point levy varies between 4 and 8 per cent. However, in the case of luxury items like motor cars, refrigerators and VCRs, the rate may go up to even 15 per cent in some States. The rate of multi-point levy hovers around 4 per cent.

Since Independence, sales tax has grown considerably in depth and coverage, and forms the mainstay of States' own tax revenue. In 1950-51, the relative share of sales tax in States' own tax revenue was 26.1 per cent: Rs 58 crore out of a total tax collection of Rs 211 crore. In 1993-94, it was estimated at 59.3 per cent (Table 2).

#### PROBLEMS CREATED BY SALES TAX

Perhaps no other tax impinges on so large a number of interests as sales tax. Firstly, it hurts the consumers who ultimately bear its burden. Next, there are the dealers from whom it is collected, and in many cases the producers also come in its ambit in case it is levied at the manufacturer's level. Then there are the State Governments, always anxious to extend its scope and retain their hold on it. Furthermore, the Central Government decides the rate of sales tax on goods of special importance in inter-State trade. Consequently, the operation of sales tax creates a host of problems which may be summarised as follows:

1. Sales tax is a levy on commodities which, in most cases, are also subject to excise duties. As excise duty and sales tax are levied by different layers of Government, it becomes difficult to determine judiciously the impact of these levies on production, investment and the consumers. No attempt to rationalise the commodity tax system can succeed if the Centre and 25 States act independently without coordination among

themselves.

2. A closely related problem is the taxation of inputs and capital goods, by the Central and State Governments, through excise duties and sales tax, respectively. Apart from generating cascading effect, sales taxation of inputs benefits the comparatively richer States at the cost of poorer States. To quote, 'The (sales) taxation of inputs also means that its burden falls on consumers outside the State. While procedures exist for refund of excise duties on a product when it is exported outside the country, the sales tax paid on inputs are not rebated. In consequence, the more developed States which have attained high levels of agricultural or industrial production are able to derive additional resources by taxing consumers in other States, while the resource mobilisation capacity of the less developed States which have to depend on most of their needs being met by imports from other States, is weakened' [Jha, 1977, p. 50]. This reverse flow of funds is further strengthened by the frequent hikes in the rate of Central sales tax. Originally at 1 per cent, the Central sales tax rate has steadily increased to 4 per cent, thereby imposing undue burden on the importing States and defeating, in the process, the very objective of the Central Sales Tax Act of 1956.

To tackle the problem of cascading effect associated with the taxation of intermediate goods, recent reforms at the Central level provide instant credit of excise duty paid on inputs under the MODVAT scheme. Although States' laws do provide relief through exemptions in regard to sales tax when inputs are sold to manufacturers, such concessions are limited and lack uniformity. This lacuna in the sales tax system has hindered reform of indirect tax system in India.

3. In order to attract trade and industry to their respective areas, some States have been indulging in a kind of 'rate war' (competitive reductions in sales tax rates). It is true that some States lack infrastructural facilities and, to compensate for that, sales tax concessions come handy to attract industries. But, this short cut erodes the resource-base of the States, so vital for the development of infrastructure, which alone

guarantees their speedy development on a permanent footing.

Differential rates of sales tax on the same set of commodities in different States often lead to uneconomic diversion of trade as well as production centres. It is not uncommon for people of one State making purchases in other States to avoid or reduce sales tax liability. Apparently, purchases from lower tax States to those where rates are higher are beneficial so long as the cost of transporting goods is lower than the tax differential. Purchase of truck chassis in Daman (a Union Territory levying a low rate of 3 per cent) by the residents of a far off State of Jammu and Kashmir is a popular case in point. Similarly, rate differentials may cause flight of capital and enterprise from high to low tax rate States, thereby distorting natural selection of production centres based on geographical advantages, leading to unnecessary transportation of raw materials and finished goods and hence cost escalations. Such a misallocation of resources undermines economic efficiency and retards developmental efforts.

4. Sales tax has another disadvantage in that it discourages horizontal integration and on the contrary encourages vertical integration in industries. Firms try to produce their own components in order to avoid sales tax. This tendency harms the growth of ancillary units which are mainly in the small-scale sector.

5. Different types of sales tax (multi-point, double-point, and single-point) with varying procedures and rules in different States cause difficulties for the traders, particularly small ones, leading to harassment, corruption and litigation.

#### ALTERNATIVE REMEDIES

To deal with the foregoing weaknesses of the sales tax system, experts have put forward various suggestions.

#### *Sales Tax as Central Levy*

It is argued that through a constitutional amendment, the levy of sales tax can also be made a Central subject and thereafter a rationalised

system of indirect taxation of domestic production and consumption can be administered by the Centre. This is a drastic suggestion which has not found favour with statesmen. The Taxation Enquiry Commission (TEC), 1953-54, was quite categorical in rejecting this suggestion. Emphasizing the impracticability of centralisation of sales tax, the Commission observed, 'On account of its yield and flexibility, sales tax has come to occupy a large and indispensable place in the State financial systems. Centralisation of the tax must be ruled out. Difficulties which confront the tax administrations vary considerably in character and composition from State to State and taken together present a large and almost bewildering variety of problems' [Matthai, 1953-54, Vol III, p. 519].

The views of the TEC appear to be still valid considering the present fiscal arrangements and political equations. Thus, a constitutional amendment to make sales tax a Central subject has to be ruled out.

#### *Complete Substitution of Sales Tax by Excise Duty*

It is suggested, particularly by the business community, that in place of sales tax corresponding enhancements should be made in Central excise duties, the proceeds of which could be earmarked for distribution among the States. This will facilitate rationalization of commodity taxation and also reduce the cost of collection apart from saving the business community from harassment from the differing sales tax practices of the various States.

Is a complete substitution of sales tax by excise duties possible? Unfortunately not. Like sales tax, excise duties cannot become universal in scope because of administrative reasons. For instance, the Centre has the legal power to impose excise duty on agricultural products but it has refrained from doing so. Similarly, small and tiny units of the industrial sector are left out because of administrative reasons. However, what is small for excise duty may be large for the purpose of



sales tax. The Indirect Taxation Enquiry Committee, 1977 estimated that nearly Rs 500 crore of sales tax was being collected on goods not subject to excise duties such as agricultural products and articles of jewellery, which for administrative or other reasons cannot be reached by excise duties. It concluded, 'The consequence of a simple abolition of sales tax from the angle of resource mobilisation would be a substantial loss of revenue to compensate for which something like a 50 per cent increase in excise duties on the average would be necessary, given the present base of excise taxation' [Jha, 1977, p. 49].

Since excise duties are of all-India nature, they cannot take into account regional variations in the levels of income and patterns of consumption. However, different rates of sales tax in individual States permit consideration of regional factors. Moreover, if sales tax is levied at the retail stage, the value base of the tax is large and even low rates of tax can yield sufficient revenues. The cumulative effect is also absent.

#### *Partial Substitution of Sales Tax by Excise Duty*

The approach towards substitution of sales tax by excise duties has to be selective. Some arrangements already exist in this regard in the form of additional duties of excise in lieu of sales tax on three important commodities, namely, textiles, tobacco and sugar. The extension of this arrangement to certain other commodities as recommended by the Tripathi Committee has already been discussed.

#### *Minimum Rate Agreement Among States*

As already noted, some States have been indulging in a sort of 'rate war' to attract trade and industry to their respective regions. To avoid this unhealthy competition, the Chief Ministers agreed, at their conference in New Delhi on February 9-10, 1989, that all the States would adopt the minimum floor level rates as recommended by the Committee of Sales Tax Commissioners in its report of 1984 in respect of 29 identified items. The follow up action is yet to

take place.

Even at the regional level, the response is not encouraging. The Chief Secretaries of northern States (Punjab, Haryana, Himachal Pradesh, Rajasthan, Delhi and Uttar Pradesh) had recommended in May 1994 that there should not only be a uniform rate of sales tax, but the slabs of this tax be reduced in these States. The recommendation is still to be implemented. The lack of concern on the part of States to harmonise their sales tax systems is apparent.

#### *Single-Point Value Added Tax (VAT)*

To deal with the cascading effects of a traditional turnover tax, some experts have suggested a single-point VAT at the Central level to replace both excise duties and sales taxes. Since sales tax is the most important source of States' tax revenue, such a drastic suggestion, which will leave the States at the mercy of the Centre, is difficult to implement. A comprehensive VAT at the national level has to be ruled out on economic as well as political considerations.

A switchover to VAT has to be an independent exercise by the Central Government and 25 State Governments. In this connection the Tax Reforms Committee, 1991 observed, 'As regards sales tax, the Committee is of the view that this tax could be converted into a form of State VAT within the manufacturing sector. There may be no need for levying sales tax at more than two rates since the distributional and other non-revenue objectives could be left to be performed by the Central taxes which apply uniformly throughout the country' [Chelliah, 1992, p. 174]. Even this dual VAT system is difficult to achieve because it is highly unlikely that the 25 States will move in tandem to ensure smooth transition to a uniform system of VAT in place of their present differing practices of sales tax. Thus, the problem of coordination is not only between the Centre and the States, but also among the States themselves.

The introduction and extension of MODVAT scheme at the Central level is a step in the right direction to reform excise taxation. Unfortunately, similar reforms have not been introduced

at the level of States. The State Finance Ministers' Conference held in New Delhi on May 27, 1994 failed to arrive at a consensus on the replacement of indirect taxes at the State level by a value added tax. The matter was deferred indefinitely by appointing a ten-member Committee of State Finance Ministers to go into this and related questions.

To conclude, it may be said that in view of the existing constitutional provisions regarding distribution of taxation powers between the Centre and the States and the emerging political equations, it is difficult to introduce a drastic and comprehensive reform of the sales tax system. Any exercise in this regard has to be limited and selective. It needs, however, to be emphasised that the States must think in terms of economic development of the country as a whole and encourage the free flow of trade and commerce in the economy. A national approach is necessary to harmonise and rationalise the existing system of commodity taxation.

#### NOTES

1. Under Article 258(1), the Union has the power to delegate to any State Government any of its executive functions (including the power to assess and collect the sales tax on inter-State trade). Thus, the power to levy and collect sales tax on inter-State trade belongs to the Centre [Article 269(1)(g)] though it has delegated the power to collect it to the States.

2. Originally, the rate was fixed at 1 per cent in 1956. It was raised to 2 per cent, 3 per cent, and 4 per cent in 1963, 1966, and 1975, respectively.

3. It means the States are free to fix the rate of sales tax on the internal sales of non-declared goods but there is a ceiling rate of 4 per cent on the sale of such goods in inter-State trade. For example, if the rate of sales tax on internal sale is 6 per cent, it will be 4 per cent for inter-State trade, being lower of the two.

4. In other words, the rate of CST is a minimum of 10 per cent. For example, if general sales tax is charged at the rate of 5 per cent on the sale of colour television in a State, the rate of CST on the same will be 10 per cent, being higher of the two rates. In 1956, the minimum rate was fixed at 7 per cent but was raised to 10 per cent by the Central Sales Tax (Amendment) Act, 1963.

5. Internal as well as inter-State sales tax on goods of special importance is governed by the Central Sales Tax Act, 1956. The present rate of CST is 4 per cent.

6. India's federal system of government creates a dual polity based on divided governmental functions and taxation powers. Taxation laws of the Central Government extend to the whole

of the country while those of State Governments are applicable within their respective jurisdictions. A tax belonging to the States may be imposed with varying base and/or rate in different States. Even the procedures and rules for its collection may differ from State to State. The lack of uniformity in the imposition of State tax laws can cause difficulties for traders and consumers and thus hinder inter-State trade. To overcome these problems, arrangements could be made to transfer from the States, the legal right to levy the tax, to the Centre with the proviso that revenue collected will be assigned to the States. This is known as 'tax rental arrangement'.

7. For example, the Third Finance Commission had to make adjustments in view of the bifurcation of Bombay State into Maharashtra and Gujarat.

8. For example, the NSS data related to the year 1972-73, and was considered outdated for the Commission's period of award (1979-84). While NSS data covered only household expenditure, the Commission was interested in non-household consumption as well.

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# SAVING AND INVESTMENT IN INDIA - TRENDS, STRUCTURAL COMPOSITION AND INTER-RELATIONSHIPS

Tarlok Singh

*The rates of both saving and investment generally showed rising trends during the four decades of planning in India. In the aggregate saving, the household sector makes the major contribution, followed by the contribution of public and private corporate sectors. In the household sector, the proportion of its saving in Capital Certain and Return Riskless Financial Assets was predominantly higher than that of Capital Uncertain and Return Risky Financial Assets. The public sector invested mainly in public utility and infrastructural industries, while the private sector invested mainly in the industries yielding direct and high returns. The Cointegration test indicated that the saving and investment were characterised by the long-run equilibrium relationship and hence there was weak mobility of international capital. The Granger test with ECM indicated that there was unidirectional causality flowing from domestic saving to investment.*

Saving and investment play a crucial role in accelerating the process of economic growth. The issue relating to the relationship between saving-investment and growth, provoked stimulating debate among the economists during the 1970s when the paradox of high saving and low growth in India came into vogue. Such phenomenon was explained mainly in terms of under-reporting of production, changes in the structure of investment and rise in the prices of machinery and equipment. The increase in saving was attributed mainly to the fall in the consumption of workers. Another important issue is the degree of international capital mobility which can be captured through the cointegrating and causal relationship between domestic saving and investment. The present study is mainly an attempt in this direction. For the purpose of analysis, the study is divided into four sections. Section-I which presents a brief profile of the data base, is followed by Section-II which sketches the trends and structural composition of saving and investment in India during the planning period (until the Seventh Plan). Section-III analyses the cointegrating and causal relationship between saving and investment. Section-IV sums up the conclusions emanating from the study.

## SECTION-I

### DATA BASE

The data used in the study have been taken from various issues of the *National Accounts Statistics* (New Series), Central Statistical Organisation, Government of India. The estimates of saving and

investment are prepared jointly by the Reserve Bank of India (RBI) and the Central Statistical Organisation (CSO). The RBI prepares the estimates of household sector saving in financial assets and the estimates of private corporate sector saving, while the CSO prepares the estimates of household sector saving in physical assets and the estimates of public sector saving. These estimates are then mutually exchanged and published in a consolidated form in the *National Accounts Statistics (NAS)* brought out by the CSO. Such estimates also appear in various RBI publications such as the *Report on Currency and Finance* and the *Annual Report*. In the overall estimates, the estimates of public sector saving and investment are prepared using the data as available in the budget documents of the government, books of accounts of various public sector enterprises, etc. These estimates are largely free from the estimation problems as compared to the estimates of household and private corporate sectors. For the estimates of household sector saving and investment, the household sector is treated as the residual sector. The reason for such residual treatment is the difficulty of obtaining direct data regarding most of the saving instruments (or books of accounts) of its constituent economic units. The economic units in the household sector include not only the consumption units like individuals, but also the unincorporated business enterprises like sole proprietorships and partnership concerns, farm-production units and a number of non-profit

organisations. The estimates of its saving in physical assets or, alternatively, the estimates of its capital formation (except for its investment in land and building) are derived as a residual item by deducting the capital formation of different sectors (others than household sector) from the total capital formation in the country. Similarly, the estimates of household sector saving in financial assets are also derived residually from the Flow-of-Fund (FOF) accounts of other sectors. In the Flow-of-Fund (FOF) accounts which are prepared by the RBI, the entire economy is classified into six major sectors. Of these, the FOF accounts for five sectors namely banking sector, other financial institutions (OFI), private corporate business, government and the rest of the world (ROW) sector, are prepared using the detailed data available for each of these sectors. The FOF accounts for the sixth (household) sector are derived residually from the FOF accounts of these five sectors, due to the difficulty of obtaining its direct data. In view of the residual nature, the revisions in the estimates of other sectors are automatically reflected in the estimates of household sector saving and investment and, hence, such estimates continue to remain provisional till the accounts of all other sectors are finalised.

The data relating to the estimates of private corporate sector (especially the non-government non-financial companies) saving and investment are also beset with certain inherent limitations. The population figures for the consolidated balance-sheet of public and private limited companies are not available and, therefore, these are arrived at by blowing-up the consolidated balance sheet of only sample (selected) companies, with the blow-up factor (W). The blow-up factor/multiplier (W) is computed as the ratio of population paid-up capital to sample paid-up capital. Alternatively,

$$\text{Blow-up Factor (W)} = \frac{\text{Population Paid-up Capital (PUC)}}{\text{Sample Paid-up Capital (PUC)}}$$

All the items in the balance-sheet are linearly blown up by an equal weight (W) irrespective of the magnitude (small or large) of such items. The population (global) estimates of saving also become susceptible to variations in the blow-up factor. Moreover, the consolidated balance sheet of medium and large public limited companies covers only 50-60 per cent, while that of private limited companies covers merely 10-15 per cent of the population companies. Apparently, the coverage of these public and private limited companies is small and, therefore, the population (global) estimates for the consolidated balance-sheet arrived at by blowing up the consolidated balance-sheet figures of these sample (selected) companies, would be untenable. Besides, the sample studies regarding the medium and large public limited companies cover only the operating companies and the non-operating companies including those in the formative stages are not considered. But the paid-up capital (PUC) figures of these companies are included in the population paid-up capital estimated for all companies. To that extent, the blow-up factor remains overestimated. Thus, the use of blow-up factor bristles with certain inherent limitations. However, in the absence of any other better indicator, it has become, more or less, an acceptable measure.

## SECTION-II

### TRENDS AND STRUCTURAL COMPOSITION OF SAVING AND INVESTMENT IN INDIA-AN OVERVIEW

The average rate of gross domestic saving (GDS) which gradually improved from 10.3 per cent in the First Plan to 13.7 per cent in the Three Annual Plans, rose remarkably to 16.1 per cent in the Fourth Plan and then to 20.4 per cent in the Fifth Plan (Table 1). During the subsequent plans (Annual Plan, Sixth Plan and the Seventh Plan), the average rate of such saving remained around 20-21 per cent. The substantial increases in the gross as well as net saving rates during the Fourth and Fifth Plans can be ascribed to the income-effect engendered by the advent of the Green Revolution in 1965, expansion of bank branches after the nationalisation of 14 major scheduled



commercial banks in 1969, introduction of compulsory deposit scheme in 1974, setting up of Regional Rural Banks (RRBs) in 1975, availability of a wide array of saving instruments and various other incentives provided to savers. Besides, the increased inflow of foreign remittances accentuated by the rise in transfer receipts

from abroad on private account during 1975-81, also contributed to the increase in the overall saving rate. In the aggregate saving (both gross and net), the household sector makes major contribution followed by the contribution of the public and private corporate sectors (Tables 3 and 4).

TABLE 1. PLAN - WISE SECTORAL RATES OF GROSS DOMESTIC SAVING (GDS)  
(ANNUAL AVERAGES)

Sector	(per cent)								
	First Plan 1951-52 to 1955-56	Second Plan 1956-57 to 1960-61	Third Plan 1961-62 to 1965-66	Three Annual Plans 1966-67 to 1968-69	Fourth Plan 1969-70 to 1973-74	Fifth Plan 1974-75 to 1978-79	Annual Plan 1979-80	Sixth Plan 1980-81 to 1984-85	Seventh Plan 1985-86 to 1989-90
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
1. Household Sector Saving	7.57	8.59	8.37	10.27	11.84	14.48	15.20	14.34	15.96
1.1 Financial Assets	1.84	2.67	3.21	2.53	3.76	5.28	5.32	6.73	7.78
1.2 Physical Assets	5.73	5.92	5.16	7.74	8.08	9.20	9.88	7.61	8.18
2. Private Corporate Sector Saving	1.03	1.21	1.71	1.24	1.55	1.53	2.06	1.62	1.91
I. Total Private Saving (1+2)	8.60	9.80	10.08	11.51	13.39	16.01	17.26	15.96	17.87
II. Public Sector Saving	1.68	1.93	3.13	2.18	2.75	4.35	4.34	3.69	2.37
III. Total Gross Domestic Saving Rate (I+II)	10.28	11.73	13.21	13.69	16.14	20.36	21.60	19.65	20.24

Note: The Rate of GDS is measured in terms of the proportion of GDS to GDP at current market prices.

In the household sector, the share of its saving in physical assets tended to decline, while that of its saving in financial assets tended to increase during the period between the First and the Seventh five year plans (Tables 3 and 4). Despite such trends, the proportion of saving in physical assets (gross) continued to remain predominantly higher than that of saving in financial assets during all the plans except for the Sixth and Seventh Plans wherein the gap between the two virtually disappeared (Table 3). An analysis of the portfolio allocation of household sector saving in financial assets indicated that the share of saving in the form of currency tended to decline particularly subsequent to the Fourth Plan which can

be attributed, *inter-alia*, to the growth of banking habits among the people after the nationalisation of banks. The proportion of household sector saving in Capital Certain and Return Riskless Financial Assets was predominantly higher than that of Capital Uncertain and Return Risky Assets which, *prima-facie*, indicates that the household sector is extremely risk averse refraining from speculative and risky financial activities.<sup>1</sup> However, the households' hesitance in such activities is not exclusively because of their risk averse attitude, but also because of their limited economic capacity and certain supply side constraints (Table 5).

(per cent)

Sector	First Plan 1951-52 to 1955-56	Second Plan 1956-57 to 1960-61	Third Plan 1961-62 to 1965-66	Three Annual Plans 1966-67 to 1968-69	Fourth Plan 1969-70 to 1973-74	Fifth Plan 1974-75 to 1978-79	Annual Plan 1979-80	Sixth Plan 1980-81 to 1984-85	Seventh Plan 1985-86 to 1989-90
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
1. Household Sector Saving	4.60	5.37	5.32	7.40	9.04	11.83	12.22	11.26	13.38
1.1 Financial Assets	1.95	2.84	3.44	2.72	4.05	5.74	5.84	7.41	8.75
1.2 Physical Assets	2.65	2.53	1.88	4.68	4.99	6.09	6.38	3.85	4.63
2. Private Corporate Sector Saving	0.46	0.50	0.64	0.15	0.53	0.35	0.87	0.35	0.52
I. Total Private Saving (I+2)	5.06	5.87	5.96	7.55	9.57	12.18	13.09	11.61	13.90
II. Public Sector Saving	0.35	0.28	1.03	-0.26	0.10	1.31	0.76	-0.15	-2.40
III. Total Net Domestic Saving Rate (I+II)	5.41	6.15	6.99	7.29	9.67	13.49	13.85	11.46	11.50

Note: The Rate of NDS is measured in terms of the proportion of NDS to NDP at current market prices.

(per cent)

[illegible]



The private corporate sector which, in the theoretical literature on economic growth, is distinguished for its higher propensity to save and passion for productive investment, could not play a significant role in the process of saving generation in India. Inter-temporally, the saving of the private corporate sector, did not display discernible improvements. The rate of its gross saving varied in the narrow range of 1.0 to 2.1 per

cent, while that of its net saving remained less than 1 per cent during the period ranging between the First and the Seventh five year plans (Tables 1 and 2). The largest proportion (around 90.0 per cent) of private corporate sector saving was contributed by the non-financial companies followed, in descending order, by the contributions of the cooperative banks and societies and the financial companies (Table 6).

TABLE 6. TRENDS IN THE COMPOSITION AND RATES OF PRIVATE CORPORATE SECTOR SAVING (GROSS)  
(ANNUAL AVERAGES)

Item	(per cent)			
	1970-71 to 1974-75	1975-76 to 1979-80	1980-81 to 1984-85	1985-86 to 1989-90
(1)	(2)	(3)	(4)	(5)
A. Composition of Saving	100.00	100.00	100.00	100.00
1. Joint Stock Companies	92.66	89.71	92.77	96.24
1.1 Non-Financial Companies	90.80	87.23	90.35	92.41
1.2 Financial Companies	1.86	2.49	2.42	3.83
2. Co-operative Banks and Societies	7.34	10.29	7.23	3.76
B. Rates of Saving				
1. Joint Stock Companies	1.55	1.39	1.50	1.72
1.1 Non-Financial Companies	1.52	1.35	1.46	1.65
1.2 Financial Companies	0.03	0.04	0.04	0.07
2. Co-operative Banks and Societies	0.12	0.16	0.12	0.19
Total (1+2)	1.68	1.55	1.62	1.91

The contribution of public sector to total saving varied in the wide range of 11.7 to 23.8 per cent in gross terms and (-) 20.8 to 15.0 per cent in net terms during the period between the First and the Seventh five year plans (Tables 3 and 4). Similarly, the rate of public sector saving ranged between 1.7 to 4.4 per cent in gross terms and (-) 2.4 to 1.3 per cent in net terms during the planning period (Tables 1 and 2). In the public sector, the savings were largely contributed by the government administration and departmental commercial undertakings, though in the Sixth and Seventh plans the pattern was reversed with the non-departmental enterprises making relatively the larger contribution (Table 7).

It may be suggested that an increase in overall saving rate requires an increase in the saving rate of the public sector, particularly that of government enterprises. However, an attempt to increase public sector saving by way of increasing taxes or slashing subsidies or by increasing prices of the products of government enterprises may

prove counter productive, as it would correspondingly crowd out the savings of the household and private corporate sectors. Therefore, the efforts should be mainly oriented towards improving its efficiency, especially through more and more introduction of modern technology.

As regards the trends in capital formation, the rates of gross as well as net domestic capital formation (investment) of different constituent sectors have shown increases of varying degree during different five year plans. The rate of gross domestic capital formation increased from 5.7 per cent in the First Plan to 8.2 per cent in the Seventh Plan in the household sector, from 1.4 per cent to 4.6 per cent in the private corporate sector and from 3.5 per cent to 10.7 per cent in the public sector during the same period. Similarly, the rates of net domestic capital formation of different constituent sectors have also shown upwards trends during the planning period (Tables 8 and 9).



TABLE 7. TRENDS IN THE COMPOSITION AND RATES OF PUBLIC SECTOR SAVING (GROSS)  
(ANNUAL AVERAGES)

Item	(per cent)								
	First Plan 1951-52 to 1955-56	Second Plan 1956-57 to 1960-61	Third Plan 1961-62 to 1965-66	Three Annual Plans 1966-67 to 1968-69	Fourth Plan 1969-70 to 1973-74	Fifth Plan 1974-75 to 1978-79	Annual Plan 1979-80	Sixth Plan 1980-81 to 1984-85	Seventh Plan 1985-86 to 1989-90
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
I. Composition of Saving	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00
1. Government Administration & Departmental Commercial Undertakings	87.48	79.56	82.81	72.31	66.08	67.96	66.68	39.18	34.80
2. Non-Departmental Enterprises	12.52	20.44	17.19	27.69	33.92	32.04	33.32	60.82	65.20
II. Rates of Saving									
1. Government Administration & Departmental Commercial Undertakings	1.49	1.55	2.59	1.58	1.82	2.96	2.90	1.54	1.17
2. Non-Departmental Enterprises	0.19	0.38	0.54	0.60	0.93	1.39	1.45	2.15	1.20
Total (1+2)	1.68	1.93	3.13	2.18	2.75	4.35	4.34	3.69	2.37

TABLE 8. PLAN - WISE SECTORAL RATES OF GROSS DOMESTIC CAPITAL FORMATION (GDCF) AT CURRENT PRICES  
(ANNUAL AVERAGES)

Sector	(per cent)								
	First Plan 1951-52 to 1955-56	Second Plan 1956-57 to 1960-61	Third Plan 1961-62 to 1965-66	Three Annual Plans 1966-67 to 1968-69	Fourth Plan 1969-70 to 1973-74	Fifth Plan 1974-75 to 1978-79	Annual Plan 1979-80	Sixth Plan 1980-81 to 1984-85	Seventh Plan 1985-86 to 1989-90
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
1. Household Sector	5.73	5.92	5.16	7.74	8.14	9.22	9.88	7.61	8.17
2. Private Corporate Sector	1.38	2.58	3.51	2.16	2.41	2.50	2.65	4.33	4.58
I. Total Private Sector Capital Formation (1+2)	7.12	8.50	8.67	9.90	10.55	11.73	12.53	11.93	12.76
3. Public Sector Capital Formation	3.52	6.20	7.75	6.62	6.84	9.00	10.33	10.20	10.66
Total Gross Domestic Capital Formation (GDCF) Rate (1+2+3)	10.63	14.70	16.42	16.53	17.40	20.72	22.86	22.14	23.42

Note: The rate of GDCF is measured in terms of the proportion of GDCF to GDP at current market prices.

TABLE 9. PLAN - WISE SECTORAL RATES OF NET DOMESTIC CAPITAL FORMATION (NDCF) AT CURRENT PRICES  
(ANNUAL AVERAGES)

Sector	(per cent)								
	First Plan 1951-52 to 1955-56	Second Plan 1956-57 to 1960-61	Third Plan 1961-62 to 1965-66	Three Annual Plans 1966-67 to 1968-69	Fourth Plan 1969-70 to 1973-74	Fifth Plan 1974-75 to 1978-79	Annual Plan 1979-80	Sixth Plan 1980-81 to 1984-85	Seventh Plan 1985-86 to 1989-90
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
1. Household Sector	2.65	2.53	1.88	4.68	5.06	6.11	6.37	3.84	4.61
2. Private Corporate Sector	0.83	1.96	2.57	1.14	1.46	1.41	1.53	3.32	3.36
I. Total Private Sector Capital Formation (1+2)	3.48	4.48	4.45	5.83	6.51	7.52	7.90	7.17	7.97
3. Public Sector Capital Formation	2.30	4.82	5.98	4.51	4.51	6.36	7.35	7.03	6.88
Total Net Domestic Capital Formation (NDCF) Rate (1+2+3)	5.78	9.30	10.43	10.34	11.02	13.88	15.24	14.20	14.85

Note: The rate of NDCF is measured in terms of the proportion of NDCF to NDP at current market prices.

An industry group-wise analysis of public sector investment indicated that the public sector invested largely in, what Hirschman [1958] called, the Social Overhead Capital (SOC) and hence shared a predominant proportion of capital formation in the public utility services and infrastructural industries like mining and quarrying, electricity, gas and water supply, transport, storage and communication and banking and insurance. The private sector invested mainly in the Directly Productive Activities (DPA) and hence shared a relatively larger proportion of capital formation in the industries yielding direct and high returns such as agriculture, manufacturing, construction, trade, hotels and restaurants and other services (Table 10). A characteristic feature of capital formation is that the gap between gross and net domestic capital formation has been found to be continuously widening which is indicative of the increasing rate of depreciation.

### SECTION-III

#### RELATIONSHIP BETWEEN SAVING AND INVESTMENT

The theoretical model, capturing the saving-investment relationship and the degree of international capital mobility, can be derived from the standard open economy equilibrium equation given by:

$$Y = C + I + G + (X - M)$$

As usual, Y stands for output or income, C for private consumption expenditure, I for investment (both public and private), G for government consumption expenditure, X for exports and M for imports. The above equation can be written as:

$$Y - (C + G) = I + (X - M)$$

or  $S = I + (X - M)$ , since  $S = Y - (C + G)$   
That is,  $0 = (I - S) + (X - M)$   
In other words,  $0 = \text{Current Account } (X - M) + \text{Capital Account } (I - S)$   
Or,  $+/- (X - M) = -/+ (I - S)$

Where S stands for saving. Thus, the surplus (+) or deficit (-) in current account (X-M) is matched by the deficit (-) or surplus (+) in the capital account. Thus, the National Income Account identity indicates the relationship between the international flow of goods and services (X-M) and the international flow of funds for capital accumulation (I-S). If  $(I - S) > 0$  [and  $(X - M) < 0$ ], then the excess investment is financed by borrowing from abroad. If  $(I - S) < 0$  [and  $(X - M) > 0$ ], then it implies that the entire saving is not invested in the domestic economy and is used for lending in the world financial market. If  $(I - S) = 0$  [and  $(X - M) = 0$ ],

TABLE 10. SECTORAL COMPOSITION OF GROSS DOMESTIC CAPITAL FORMATION (GDCF) IN PUBLIC AND PRIVATE SECTORS (AT 1980-81 PRICES)  
(ANNUAL AVERAGES)

Industry-Group	(per cent)																	
	Period I 1960-61 to 1964-65			Period II 1965-66 to 1969-70			Period III 1970-71 to 1974-75			Period IV 1975-76 to 1979-80			Period V 1980-81 to 1984-85			Period VI 1985-86 to 1988-89		
	Public Sector	Private Sector	Total	Public Sector	Private Sector	Total	Public Sector	Private Sector	Total	Public Sector	Private Sector	Total	Public Sector	Private Sector	Total	Public Sector	Private Sector	Total
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)	(17)	(18)	(19)
1. Agriculture and Allied Activities	36.20	63.80	100.00	29.40	70.60	100.00	30.50	69.50	100.00	33.40	66.60	100.00	39.20	60.80	100.00	34.40	65.60	100.00
1.1 Agriculture	36.20	63.80	100.00	29.30	70.70	100.00	30.50	69.50	100.00	33.40	66.60	100.00	38.90	61.10	100.00	34.40	65.60	100.00
2. Mining & Quarrying	81.10	18.90	100.00	86.90	13.10	100.00	87.70	12.30	100.00	87.50	12.50	100.00	92.70	7.30	100.00	95.30	4.70	100.00
3. Manufacturing	29.70	70.30	100.00	33.30	66.70	100.00	29.90	70.10	100.00	37.60	62.40	100.00	34.00	66.00	100.00	35.90	64.10	100.00
4. Electricity, Gas & Water Supply	94.20	5.80	100.00	96.40	3.60	100.00	93.70	6.30	100.00	97.70	2.30	100.00	92.50	7.50	100.00	94.80	5.20	100.00
5. Construction	10.90	89.10	100.00	11.20	88.80	100.00	21.50	78.50	100.00	28.50	71.50	100.00	19.50	80.50	100.00	13.20	86.80	100.00
6. Trade, Hotels & Restaurants	11.00	89.00	100.00	70.50	29.50	100.00	38.80	61.20	100.00	27.40	72.60	100.00	13.50	86.50	100.00	30.90	130.90	100.00
7. Transport, Storage & Communication	72.20	27.80	100.00	67.00	33.00	100.00	64.60	35.40	100.00	67.20	32.80	100.00	57.80	42.20	100.00	54.60	45.40	100.00
8. Banking & Insurance	43.70	56.30	100.00	48.10	51.90	100.00	72.60	27.40	100.00	67.10	32.90	100.00	57.00	43.00	100.00	63.20	36.80	100.00
9. Public Administration & Defence	100.00	0.00	100.00	100.00	0.00	100.00	100.00	0.00	100.00	100.00	0.00	100.00	100.00	0.00	100.00	100.00	0.00	100.00
10. Other Services	8.80	91.20	100.00	7.60	92.40	100.00	12.80	87.20	100.00	13.10	86.90	100.00	14.20	85.80	100.00	17.40	82.60	100.00
Total Gross Domestic Capital Formation (GDCF)	45.30	54.70	100.00	44.50	55.50	100.00	44.60	55.40	100.00	48.30	51.70	100.00	48.50	51.50	100.00	48.00	52.00	100.00

then it indicates that the entire saving is invested domestically and hence nothing is left for lending in the world financial market. In other words:

$$S - I = 0 \text{ or } I = S$$

Since it is a standard approach to use saving and investment in terms of their rates rather than levels, we divide both sides by output ( $Y$ ) and write the above deterministic equation in stochastic form as:

$$I/Y = a + b (S/Y) + u, \text{ where } b > 0$$

In the above equation, if 'b' is statistically close to 1, then it would imply that the domestic investment is largely financed by the domestic saving. Alternatively stated, the domestic saving remains restricted to the financing of domestic investment and hence is not perfectly mobile across countries. Such saving-investment approach to international capital mobility, was initially propounded by Feldstein and Horioka [1980, Pp. 314-329] who conducted a cross-sectional study for the relationship between saving and investment rates of 21 OECD countries during 1960-74. They found the existence of a significant relationship between domestic saving and domestic investment rates in such countries and hence the absence of perfect capital mobility. Such conclusions were confirmed again by Feldstein [1983, Pp. 129-151]. Subsequently, largely similar results were obtained by Penati and Dooley [1984, Pp. 1-24], Monadjemi [1990, Pp. 30-39] and Leachman [1990, Pp. 23-39].

All these studies used the usual method of regression analysis. However, such method can yield misleading inferences, if the series under reference contain unit roots (as discussed subsequently). In the present study, we have used the recent technique of cointegration to analyse the relationship between the rates of domestic saving and investment. The absence of cointegrating relationship between the rates of domestic saving and investment would indicate that the domestic saving is not restricted to the financing of domestic investment and, instead, is responsive to the rates-of-return available in the world

financial market. Similarly, the investment would be financed largely by the general pool of world capital and not necessarily by the domestic saving. On the contrary, the presence of a cointegrating relationship between domestic saving and investment would imply that the domestic saving remains restricted to the financing of domestic investment and hence is not perfectly mobile across countries.

Granger [1988, Pp. 199-211] observed that when a set of time series is cointegrated and is represented by an error-correction model, then there must be a Granger-causation flowing at least in one direction and, thus, implying that one variable can be used to forecast the other. The Granger-causation flowing from investment to saving would indicate that an exogenous increase in investment would lead to an increase in income through the multiplier mechanism and hence would result in higher saving. On the other hand, the causality flowing from domestic saving to investment would imply that the domestic investment is tied to domestic saving. In such a case, the domestic saving which constitutes the supply of loanable funds would be financing domestic investment which constitutes the demand for loanable funds. The Solow model indicates that the saving rate is a key determinant of the steady-state capital stock. The higher saving rate would lead to a higher rate of investment (or higher capital stock) and hence would result in a higher level of output and vice versa. The rate of saving, thus, becomes an important determinant of economic growth.

To test the cointegrating and causal relationship between the rates of domestic saving and investment in India, we have used the data for a sample space of 41 years spanning from 1951-1991. As mentioned earlier, due to the increasing rate of depreciation, the gap between 'gross' and 'net' series of saving as well as those of investment has been widening. Consequently, the results arrived at on the basis of gross series may sometimes differ from those obtained from the net series of saving and investment rates. In view of this, we have carried out the cointegration and causality tests for both the 'gross' and 'net'

series of saving and investment rates. The definitional details of the variables used in the model are given in the Appendix.

### 3.1 Unit Root Test

Only the series integrated of the same order, can be cointegrated and, therefore, we have first carried out the unit root test, so as to identify the order of integration and random walk characteristics of our series of saving and investment rates. Consider a simple univariate time series model with first-order autoregression AR (1) and white noise innovations, specified by:

$$Y(t) = \beta Y(t-1) + \mu(t) \quad (1)$$

For the stability<sup>2</sup> and stationarity of  $Y(t)$  series, we require  $|\beta| < 1$ . If  $|\beta| > 1$ , then the  $Y(t)$  series is not stationary and equation (1) becomes explosive (or unstable) and the variance of the series increases exponentially overtime. If  $|\beta| = 1$ , then the series  $Y(t)$  is termed as simple *random walk* containing unit roots. Such series is again not stationary and its variance would increase with time, i.e., the  $\text{Var}(Y) = \sigma^2(t)$ . In such case, the deviations from the mean are permanent and the series  $Y(t)$  can wander far away from its mean. The levels of such series become unduly small or large, without having any tendency to revert back to their mean levels. As a matter of fact, with the increase in time, the  $\sigma^2(t) \rightarrow \infty$  and the mean of the series becomes non-existent. Thus, the concepts of mean and variance become meaningless in the case of non-stationary and integrated series. Thus, in the regression involving the levels of strongly trended and integrated data series with unit roots, the regressor will have an infinite variance and, therefore, the least squares estimators would be heavily biased. As a result, the conventional test statistics [ $t$ ,  $R^2$  or  $F$ ] would yield misleading statistical inferences. In such a case, Dickey and Fuller provided a new set of critical values.

If equation (1) contains a constant  $\alpha_0$ , then it is said to be a *random walk* with drift:

$$Y(t) = \alpha_0 + \beta Y(t-1) + \mu(t) \quad (2)$$

or

$$\Delta Y(t) = \alpha_0 + \mu(t) \quad (3)$$

if  $\beta = 1$

In the presence of unit roots, it is very unlikely that a significant time trend would occur as it would imply that the rate of change of the dependent variable is deterministic; ever decreasing if the coefficient of a time trend is less than zero and ever increasing if it is greater than zero [Nelson and Plosser, 1982, Pp. 139-162]. Dickey, Bell and Miller recommended against the inclusion of a time trend in a univariate time series model, as the inclusion of time trend would make the random walk model look stationary [Dickey, Bell and Miller, 1986, Pp. 12-26]. However, Evans and Savin suggested for the inclusion of time trend even if it is not a significant variable, as its absence would make the distribution of  $\beta$  statistics dependent on the characteristics of an unknown parameter  $\alpha_0$  [Evans and Savin 1984, Pp. 1241-1269]. We included the time trend ( $T$ ) in our model and such model is specified as:

$$Y(t) = \alpha_0 + \alpha_1 T + \beta Y(t-1) \quad (4)$$

Subtracting  $Y(t-1)$  from both sides of equation (4) and also augmenting the model with 'K' additional terms of the lagged dependent variable so as to achieve white-noise residuals, we have:

$$\Delta Y(t) = \alpha_0 + \alpha_1 T + \alpha_2 Y(t-1) + \sum_{i=1}^K \alpha_3(i) \Delta Y(t-i) + \varepsilon(t) \quad (5)$$

In the Dickey-Fuller (D-F) [ $K = 0$ ] or the Augmented Dickey Fuller [ADF] [ $K > 0$ ] regression equation (5),  $\alpha_2 = (\beta - 1)$  and, therefore,  $\alpha_2 = 0$  corresponds to  $\beta = 1$ . If null of  $\alpha_2 = 0$  is not rejected against the alternative that  $\alpha_2 < 0$ , then the series is said to be non-stationary. To test the null of unit roots [ $\alpha_2 = 0$ ], we compare the 't' statistics with the corresponding critical values [as given in Fuller, 1976, Table 8.5.2, p. 373].



Since the relevant distribution is conditional upon  $\alpha_1$  being zero, we also used  $\Phi_3$  (or  $F$ ) statistics to test the null for the restrictions of  $\alpha_1 = \alpha_2 = 0$  (i.e. random walk with drift). If the  $\Phi_3$  statistics is greater than critical value, then the null is rejected. If the coefficient of time trend cannot be restricted to zero (i.e., if  $\alpha_1 \neq 0$ ), then the series is said to contain trend which should be removed prior to further modelling or else a time trend should be included in the subsequent regressions.

In equation (5), the lag structure  $K$  was selected such that it eliminated serial correlation. The results obtained for the Dickey-Fuller tests strongly support for the acceptance of null hypothesis and hence the presence of unit roots

in log level series. The  $\Phi_3$  statistics as well as the  $t$ -statistics computed for the log level series at different values of  $K$ , are less (in absolute terms) than their corresponding critical values (Table 11). However, in the case of the series with first difference operator ( $\Delta$ ) the results reject the null of unit roots as the calculated  $\Phi_3$  statistics are greater than their critical levels and the  $t$ -statistics are algebraically smaller than their critical levels. The individual coefficient of time trend variable is also found to be statistically insignificant. It can be inferred from this that the series of saving and investment rates are stationary at first differences and, thus, are individually integrated of order one  $[I(1)]$ .

TABLE 11. AUGMENTED DICKEY-FULLER TESTS FOR THE NULL HYPOTHESIS OF UNIT ROOTS (PERIOD: 1951-1991)

Variable	T		Y [t-1]		$\Phi_3$	Degree of Freedom	K	$\chi^2[p=1]$
	Coeff.	t-Value	Coeff.	t-Value				
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
<b>At Log Levels</b>								
LRGS	0.00707	(1.58)	-0.38807	(-2.05)	3.37	(5,31)	3	0.09072
LRGCF	0.01554	(2.36)	-0.85483	(-2.45)	2.12	(8,25)	6	0.93523
LRNS	0.00812	(1.37)	-0.37117	(-1.92)	2.94	(5,31)	3	0.02358
LRNCF	0.01750	(2.20)	-0.85980	(-2.35)	2.13	(8,25)	6	0.52912
<b>At <math>\Delta</math> Log Levels</b>								
$\Delta$ LRGS	-0.00034	(-0.22)	-0.97483	(-5.86)	17.22	(2,36)	0	2.4984
$\Delta$ LRGCF	-0.00187	(-1.25)	-1.2563	(-6.44)	20.57	(3,34)	1	0.41375
$\Delta$ LRNS	-0.00212	(-0.78)	-1.3596	(-6.60)	19.42	(3,34)	1	1.5802
$\Delta$ LRNCF	-0.00323	(-1.20)	-1.2536	(-6.57)	25.60	(3,34)	1	0.00235

Note: The Critical Dickey-Fuller values at 1 per cent level of significance are -2.66 at 25 degrees of freedom and -2.62 at 50 degrees of freedom. A comparison of the calculated  $t$ -values (as given in Column-5 above) with the critical  $t$ -values indicates that the null of Unit Roots is accepted in the case of log level series, while it is rejected in the case of first difference ( $\Delta$ ) of log series.

Similarly, the Critical Dickey-Fuller values of  $F$ -statistics at 1 per cent level of significance are 10.61 at 25 degrees of freedom and 9.31 at 50 degrees of freedom. A comparison of the calculated  $\Phi_3$  - values (as given in Column-6 above) with the critical  $F$ -values also indicates that the null of Units Roots is accepted in the case of log level series, while it is rejected in the case of first difference ( $\Delta$ ) of log series.

### 3.2 Test for Cointegration

The series are said to be cointegrated, if they share a common stochastic trend. The cointegrating process is modelled by estimating the least squares regressions for the non-stationary series itself, as the back-shift operator used for obtaining stationarity would obscure the long-run relationship. Accordingly, at the first stage of

Engle-Granger cointegration test, the regression was estimated for the levels of data series which were found to be individually integrated of the same order, i.e.,  $I(1)$ . Such cointegrating regression is specified by:

$$Y(t) = \beta_0 + \beta_1 X(t) + v(t) \quad (6)$$

At the second stage, we test the null of unit roots in the residuals  $[v(t)]$  of the cointegrating regression (6) by estimating the following regression:

$$\Delta v(t) = \lambda_0 v(t-1) + \sum_{i=1}^m \lambda_i (i) \Delta v(t-i) \quad (7)$$

The cointegration, thus, combines different series which are integrated of the same order, into a univariate series  $v(t)$  which should be stationary having its expected value to be zero.

The rejection of the null of unit roots  $[\lambda_0 = 0]$  in the residuals of cointegrating regression would corroborate the co-movements and, hence, the existence of stable long-run link between the given series. The distance between such time series would be stable around a fixed mean and the series will not diverge without limits. These series would be drifting upward together roughly at the same rate. In such cointegrating model, the estimates of the long run coefficients are consistent and highly efficient, converging to their true parameter values at a much faster rate than

the standard regression estimates. Thus,  $\beta_1$  in model (6) would be a consistent estimator  $\beta_1$  in the steady-state equilibrium relationship.

One problem which arises in the Engle-Granger procedure is that there is no *a priori* theory to suggest as to which of the two series can be chosen to normalise on<sup>3</sup> and in view of this, we have estimated each regression twice in both the directions. However, the results so obtained for both these directions were largely similar, although in some cases we had to use different lag order of the dependent variable to achieve white noise innovations. These results reject the null of  $\lambda_0 = 0$  and, thus, confirm the  $I(0)$  characteristics of the residuals of cointegrating regression (Table 12). Thus, there exists a steady-state equilibrium relationship between the rates of saving and investment in India. The existence of cointegrating relationship between saving and investment indicates that the domestic saving and investment are tied together and hence there is weak mobility of international capital.

TABLE 12. COINTEGRATING REGRESSIONS AND TESTS FOR COINTEGRATION (PERIOD: 1951-1991)

Eqn. No.	Model		Parameters		$R^2$	DW	$\lambda_0$	m	$\chi^2 [p=1]$
	Y (t)	X (t)	$\beta_0$	$\beta_1$					
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
1.	LRGS	LRGCF	0.69671 (2.66)	0.72817 (8.79)	0.95883	1.85	-1.0541 (-4.78)	1	1.0231
2.	LRGCF	LRGS	0.30090 (1.42)	0.92589 (12.09)	0.94514	1.82	-0.76894 (-4.34)	1	0.08909
3.	LRNS	LRNCF	0.38016 (1.76)	0.76508 (9.37)	0.92349	1.80	-0.97975 (-4.54)	1	1.1163
4.	LRNCF	LRNS	0.35359 (1.72)	0.91993 (10.02)	0.89571	1.89	-0.38999 (-3.18)	0	0.00023

Notes: 1. The figures in parentheses are t-values.

2. The residuals derived from each cointegrating regression were tested for the null of Unit roots, using both the non-augmented Dickey-Fuller (DF) and the Augmented Dickey Fuller (ADF) tests.

### 3.2.1. Error Correction Model (ECM)

An essential feature of cointegration analysis is that it provides support for the use of error correction model (ECM) in the formulation of econometric models. Such a link between the

cointegrating concept and ECM is widely known as the *Granger representation theorem*. The idea is that if a set of  $I(1)$  variables is cointegrated, there always exists at least one ECM representation among the variables concerned.<sup>4</sup> The ECM, which measures the magnitudes of dynamic

adjustment coefficients, uses the residuals obtained from the static cointegrating regression (6), as an error correction term in the dynamic first-difference regression. Thus, if  $v(t)$  is  $I(0)$ , then an error correction mechanism represented by

$$\Delta Y(t) = \theta_0 + \theta_1 \Delta X(t) + \theta_2 v(t-1) + u(t) \quad (8)$$

yields a useful short-run adjustment model to be estimated, as all the terms are  $I(0)$ . In the ECM

model (8), the estimates of the coefficient of error correction term ( $\theta_2$ ) can be interpreted as the short run adjustment factor or as the proportion of the current disequilibrium which is reflected in the movement of the dependent variable in any one period. Alternatively stated, the coefficient ( $\theta_2$ ) of equilibrium error indicates the dynamics of short-run adjustment process in each year.

TABLE 13. ERROR CORRECTION MODEL (ECM) FOR RATES OF SAVING AND INVESTMENT (PERIOD: 1951-1991)

Eqn. No.	Model			Parameters		Test Statistics			
	$\Delta Y(t)$	$\Delta X(t)$	$v(t-1)$	$\theta_1$	$\theta_2$	$R^2$	DW	SEE	Mean
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
1.	$\Delta LRGS$	$\Delta LRGCF$	ECT (t-1)	0.88358 (10.67)	-0.44581 (-1.71)	0.75734	1.93	0.05000	0.01990
2.	$\Delta LRGCF$	$\Delta LRGS$	ECT (t-1)	0.78562 (9.66)	-0.66029 (-3.29)	0.78503	2.03	0.04834	0.01858
3.	$\Delta LRNS$	$\Delta LRNCF$	ECT (t-1)	0.975 (11.65)	-0.53091 (-2.11)	0.76845	1.94	0.09195	0.02164
4.	$\Delta LRNCF$	$\Delta LRNS$	ECT (t-1)	0.88892 (9.26)	-0.38067 (-2.90)	0.75923	1.91	0.11629	0.02493

Note: The Error Correction Terms (ECT) for the endogenous variables have been obtained as the residuals of their respective cointegrating models given in Table 12 above.

The results obtained for the ECM model (8) are found to be tenable in terms of all the test statistics (Table 13). The coefficients of the equilibrium error ( $\theta_2$ ) which explain the short-run dynamics indicated that, within one year, approximately 45 per cent of the error is corrected in the case of the rate of gross domestic saving (RGS), 66 per cent in the case of the rate of gross domestic capital formation, 53 per cent in the rate of net domestic saving and 38 per cent in the rate of net domestic capital formation. It may be mentioned that the regression coefficients of the error correction terms [ECT (t-1)] are statistically insignificant in the case of saving equations (1) and (3), while in the case of investment equations (2) and (4), the regression coefficients of ECT (t-1) are statistically significant (Table 13). It can be construed from this that the investment adjusts to savings in the Indian economy. These results are further corroborated by the unidirectional causality running from the rate of domestic saving to investment in the Granger-causality with error

correction model (ECM) discussed subsequently.

### 3.3. Test for Causality

The causal relationship between the rates of saving and investment has been examined, using alternatively the Granger test and the VAR model.

#### 3.3.1. Granger-Causality: A Standard Case

The unrestricted specification of the standard Granger [1969, Pp. 429-438] causality test for the bivariate time-series set, is given by:

$$\Delta Y(t) = \delta_0 + \sum_{i=1}^p \delta_{1i} \Delta Y(t-i) + \sum_{j=1}^q \delta_{2j} \Delta X(t-j) + \varepsilon(1t) \quad (9)$$

$$\Delta X(t) = \gamma_0 + \sum_{i=1}^p \gamma_1(i) \Delta X(t-i) + \sum_{j=1}^q \gamma_2(j) \Delta Y(t-j) + \epsilon(2t) \quad (10)$$

The causal inferences are frequently sensitive to the choice of the appropriate length of various lag polynomials. We have adopted the sequential approach for the selection of appropriate lag structure of one dimensional autoregressive as well as bivariate models, by combining the Akaike's [1970, Pp. 203-217] Final Prediction Error (FPE)<sup>5</sup> criterion suggested by Hsiao [1979, Pp. 553-560 and 1981, Pp. 85-106] with the Granger's concept of causality to determine the lag order of 'p' and 'q' in equations (9) and (10). In the FPE procedure, a step-wise ranking of FPEs

is made as incremental lags are added first to univariate equations so as to decide the appropriate lag order of 'p' and then to bivariate equations so as to decide the optimal order of 'q'. The lag order (p or q) that minimises the value of FPE is considered optimal.

The partial F-statistics obtained from the standard Granger-causality models (equations - 9 and 10) indicate that the null hypothesis of no feedback causality between the rates of saving and investment is rejected (Table 14). The statistically significant F-statistics for the bivariate model with different lag polynomials, indicate that the bi-directional causal flows characterise the relationship between the rates of both gross as well as net saving and investment in India.

TABLE 14. GRANGER CAUSALITY BETWEEN THE RATES OF SAVING AND INVESTMENT (PERIOD: 1951-1991)

Eqn. No.	Model			K	Degree of Freedom	F
	$\Delta Y(t)$	$\Delta Y(t)$	$\Delta X(t)$			
(1)	(2)	(3)	(4)	(5)	(6)	(7)
1.	$\Delta LRGS$	$\Delta LRGS(-3)$	$\Delta LRGS(-5)$	9	5.26	6.02
2.	$\Delta LRGCF$	$\Delta LRGCF(-6)$	$\Delta LRGCF(-1)$	8	1.26	3.50
3.	$\Delta LRNS$	$\Delta LRNS(-3)$	$\Delta LRNS(-5)$	9	5.26	6.50
4.	$\Delta LRNCF$	$\Delta LRNCF(-6)$	$\Delta LRNCF(-1)$	8	1.26	7.49

Notes: 1. K: indicates the number of parameters.

2. The Figures in parentheses indicate the number of lags of the associated variable, truncated at the minimum value of Akaike's FPE.

### 3.3.2. Granger-Causality with Error Correction Model (ECM)

When the series are cointegrated as indicated by model (8), then the omission of the error correction term (ECT) from the model can lead to incorrect inferences regarding the existence of causality. That is, it can bias the test results in favour of rejection of the null of Granger causality. Thus, the aforementioned specifications for Granger test (equations - 9 and 10) admittedly suffer from the problem of specification error. In view of this, we would now examine the Granger causality with error correction model. As mentioned earlier, when a set of time series is cointegrated and is represented by an error-correction model, then there must be a Granger-causation flowing at least in one direction. The error-correction representation of the standard Granger

model which provides an additional channel for the causal relationship between the pairs of relevant series, is given by:

$$\Delta Y(t) = \delta_0 + \sum_{i=1}^p \delta_1(i) \Delta Y(t-i) + \sum_{j=1}^q \delta_2(j) \Delta X(t-j) + \delta_3 v_1(t-1) \quad (11)$$

$$\Delta X(t) = \gamma_0 + \sum_{i=1}^p \gamma_1(i) \Delta X(t-i) + \sum_{j=1}^q \gamma_2(j) \Delta Y(t-j) + \gamma_3 v_2(t-1) \quad (12)$$

In model (11),  $v_1$  are the Error Correction Terms (ECT) or the residuals which were obtained from the cointegrating regression of the levels of Y on the levels of X as given in equation (6). Similarly,  $v_2$  in model (12) is the ECT obtained by estimating

the cointegrating regression equation (6) in reverse direction with the levels of  $X$  as the dependent variable and the levels of  $Y$  as the independent variable. Since  $v_i(t-1)$  [ $i=1, 2$ ] depends on the lagged levels of  $Y(t)$  and  $X(t)$ , the foregoing models (11 and 12) indicate that either  $\Delta Y(t)$  or  $\Delta X(t)$  or both must be Granger-caused by the lagged levels of these variables. Thus, the levels of the rates of saving and investment regressors enter the models (11 and 12) through the residuals and, thus, Granger-cause the rates of saving and investment.

In equation (11), the presence of causality between two variables is established through both tests of the joint significance of the coefficients  $\delta_2(j)$ 's and the significance of the error correction coefficient  $\delta_3$ . Thus, the variable ' $X$ ' is said to Granger-cause the variable ' $Y$ ', if either the coefficient of error correction term ( $ECT$ ) is significant or the  $\delta_2(j)$ 's coefficients are jointly significant, or both. Similarly, in the error correction model (12), the causality can be established through both the tests of the joint significance of the coefficients  $\gamma_2(j)$ 's and the significance of the error correction coefficient  $\gamma_3$ . Accordingly, the variable ' $Y$ ' can be said to cause the variable ' $X$ ', if either the coefficient of error correction term ( $ECT$ ) is significant or the  $\gamma_2(j)$ 's coefficients are jointly significant, or both. For the selection of the lag length of ' $p$ ' and ' $q$ ' in the

Granger causality with error correction model, we have used chi-square  $\chi^2$  test. The  $\chi^2$  statistic is the Breusch Godfrey Lagrange Multiplier (LM) test statistic and is obtained by regressing the OLS residuals on the exogenous variables of the model plus the autoregressive lags of such residuals.<sup>6</sup> Under the null of no autocorrelation, the LM ( $p$ ) statistic is asymptotically distributed as  $\chi^2$  with  $p$  degrees of freedom.

The results obtained from the Granger-causality with ECM were found to be somewhat different from those obtained earlier from the standard Granger model. The regression coefficients of the lagged residuals or the Error Correction Term [ $ECT(t-1)$ ] series were found to be statistically significant only in the case of the equations with the rate of investment [gross (RGCF) as well as net (RNCF)] as the dependent variable (Table 15, Equations - 2 and 4). In such equations, the  $F$  statistics were also statistically significant. These results, thus, indicated the existence of unidirectional causality running from domestic saving to investment. In the case of the model with the rate of saving [gross (RGS) as well as net (RNS)] as the dependent variable, the regression coefficients of the lagged residuals or the Error Correction Term [ $ECT(t-1)$ ] series were not statistically significant (Table 15, Equations - 1 and 3). In these equations, the  $F$  statistics were also not statistically significant. Thus, the feedback flow from investment to saving was found to be conspicuous by its absence.

TABLE 15. F-STATISTICS AND ERROR CORRECTION COEFFICIENTS FOR GRANGER CAUSALITY (PERIOD: 1951-1991)

Eqn. No.	Model				K	Degree of Freedom	F	ECT (t-1)		
	$\Delta Y(t)$	$\Delta Y(t)$	$\Delta X(t)$	$ECT(t-1)$				Coefficient	t-value	$\chi^2[p=1]$
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)
1.	$\Delta LRGS$	$\Delta LRGS(-2)$	$\Delta LRGS(-3)$	$ECT(t-1)$	7	4,30	2.97	-0.82487	-0.77	0.07982
2.	$\Delta LRGS$	$\Delta LRGS(-1)$	$\Delta LRGS(-3)$	$ECT(t-1)$	6	4,31	11.34	-1.64720	-2.93	0.34080
3.	$\Delta LRNS$	$\Delta LRNS(-2)$	$\Delta LRNS(-3)$	$ECT(t-1)$	7	4,30	3.66	-0.29364	-0.34	0.00001
4.	$\Delta LRNS$	$\Delta LRNS(-2)$	$\Delta LRNS(-3)$	$ECT(t-1)$	7	4,30	5.61	-0.70753	-3.16	0.70305

Notes: 1. K: indicates the number of parameters.

2. The Figures in parentheses indicate the lag truncations.

3. The ECT denotes the Error Correction Terms ( $v_1$  and  $v_2$ ) for the model under reference.

The presence of a long-run cointegrating relationship followed by the unidirectional Granger-causality running from the rate of saving (both net and gross) to investment indicates that the domestic saving finances domestic investment. The rate of domestic saving constrained the rate of investment and hence the pace of economic growth in India. The cointegrating and causal relationship between the rates of domestic saving and investment is valid even in the present policy regime of opening up of Indian economy. In the present policy framework, a macroeconomic stabilisation programme was launched in July 1991 and bold policy initiatives were undertaken by the government in the fiscal and external sectors supplemented with the simultaneous reforms in the financial, industrial and agricultural sectors. However, such policy changes did not affect the equilibrium relationship between domestic saving and investment. Thus, the domestic saving continues to finance a predominant proportion of domestic investment in India and there is little reliance on foreign saving or alternatively the *net inflow of foreign resources* even in the present policy regime. In the recent years during 1991-94, the average rate of aggregate gross domestic investment at 25 per cent comprised predominantly the rate of gross domestic saving at 24 per cent. The inflow (net of outflow) of foreign resources, as a proportion of GDP at current market prices, was only 1 per cent. By and large, similar pattern and composition was observed for the rate of net domestic investment.

### 3.3.3. Vector Autoregression (VAR) Model

The data driven VAR models are basically used for the purpose of forecasting, as an alternative to the structural econometric models. The VAR which estimates the system of equations through interactive procedure can be specified, with  $p=1$ , as:

$$S(t) = a*S(t-1) + b*I(t-1) + u(t) \quad (13)$$

$$I(t) = c*S(t-1) + d*I(t-1) + v(t) \quad (14)$$

where;

$$E \begin{bmatrix} u(t) \\ v(t) \end{bmatrix} \begin{bmatrix} u(t) & v(t) \end{bmatrix} = \Sigma = \begin{bmatrix} \sigma_{11} & \sigma_{12} \\ \sigma_{21} & \sigma_{22} \end{bmatrix}$$

The AR models (13) and (14) contain the lagged explanatory variables and the current disturbance term. Thus, such error term is the only new contributing factor to the dependent variable in the current period and as such it is termed as the innovation for that variable in the current period. For each variable, we have computed a time series of all innovations. Thereafter, through the process of successive substitution, the current values of the dependent variables are specified in terms of the current as well as lagged values of the innovations of all the variables in the system and, thus, the moving average representations (MARs) are computed as:

$$S(t) = u(t) + au(t-1) + (a^2+bc)u(t-2) + \dots + bv(t-1) + (ab+bd)v(t-2) + \dots \quad (15)$$

$$I(t) = cu(t-1) + (ac+cd)u(t-2) + \dots + v(t) + dv(t-1) + (bc+d^2)v(t-2) + \dots \quad (16)$$

Thus, the VAR analyses the dynamic impact of different random disturbances and controls on the system of variables. The MARs embodied in equation (15) measure the effect of a standard deviation change in innovation  $u(t)$  on the  $S(t)$ .

It is difficult to interpret the estimated coefficients of VAR and, therefore, we usually look at the impulse response functions and variance decompositions of the system so as to draw implications about a VAR. An impulse response function traces out the response of the endogenous variable in the system to the shocks given to the innovations. For instance, the effects of a standard deviation shock given to the innovations of saving on investment would be termed as the impulse response function of investment with regard to saving. An impulse response function which describes the dynamics of VAR system, decomposes the determinants of the endogenous variable into the innovations identified with specific variable.

The Forecast Error Variance (FEV) derived therefrom for each variable, is the sum total of the variances and covariances of all innovation series.



Thereafter, the variance decomposition (VARD) is computed which indicates the K step ahead FEV of the rates of saving and investment attributable to the shocks given to the innovations of such rates of saving and investment. An analysis of the effect of the innovations of each variable on the movements of each variable in the system, would enable to determine the causal flows. However, due to the presence of contemporaneous correlation between  $u(t)$  and  $v(t)$ , the change in  $u(t)$  will simultaneously result in a corresponding change in  $v(t)$  which, in turn, would result in a change in  $I(t)$  as given in equation (16). Thus, the change in  $v(t)$  cannot be exclusively attributed to the pure innovations of  $I(t)$ . When the contemporaneous innovations are correlated, they possess a common component which cannot be attributed to any specific variable and, as a result, it becomes difficult to interpret the VARD statistics. It is, therefore, necessary to *orthogonalize the matrix of innovations* so as to

*eliminate* the contemporaneous correlation. An arbitrary method for such orthogonalization is to attribute all the effects of any common component to the variable which is ordered first in the system. However, altering the order of the equation can dramatically affect the impulse responses and FEV. In view of this, it is necessary to note that the FEV should be consistent across alternative ordering schemes.

We have computed VARD statistics under both the ordering schemes (Table 16). The saving can be said to cause investment, if more than 50 per cent of the FEV of investment, at K step ahead, is explained by the innovations in saving and vice versa. The VARD results indicated that under the alternative ordering schemes, the bi-directional causality characterised the relationship between the rates of saving and investment in both gross as well as net terms. These results are similar to those obtained earlier from the standard Granger model.

TABLE 16. VARIANCE DECOMPOSITION (VARD) FOR THE RATES OF SAVING AND INVESTMENT (PERIOD: 1951-1991)  
(per cent)

Period	LRGS (1)		LRGCF (1)		LRNS (1)		LRNCF (1)	
	LRGS	LRGCF	LRGCF	LRGS	LRNS	LRNCF	LRNCF	LRNS
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
1.	100	-	100	-	100	-	100	-
2.	85.05	14.95	99.95	00.05	73.17	26.83	99.15	00.85
3.	61.26	38.74	77.71	22.29	46.34	53.66	71.31	28.69
4.	48.68	51.32	51.58	48.42	35.85	64.15	47.86	52.14
5.	45.19	54.81	47.39	52.61	32.85	67.15	43.06	56.94
6.	41.62	58.38	44.43	55.57	30.17	69.83	40.10	59.90
7.	41.04	58.96	45.42	54.58	31.58	68.42	45.10	54.90
8.	42.13	57.87	44.64	55.36	33.47	66.53	45.44	54.56

Note: The Figures in brackets in the upper row indicate the ordering of equations under reference in the VAR model.

#### SECTION - IV

#### CONCLUSION

It can be inferred from the foregoing analysis that the rate of gross domestic saving (GDS) which showed a continuously rising trend until the Fifth Plan, remained around 20-21 per cent during the subsequent plans. In the aggregate saving (both gross and net), the household sector makes the major contribution followed by the contribution of the public and private corporate

sectors. The rate of private corporate sector saving varied in the range of 1.0 to 2.1 per cent in gross terms and remained less than 1 per cent in net terms during the planning period. The rate as well as share of public sector saving (net) were found to be not only low, but also negative in some of the plans (Three Annual Plans, Sixth Plan and the Seventh Plan). As regards capital formation, the rates of both gross and net domestic capital formation showed a rising trend during the planning period. A characteristic feature of the

capital formation is that the gap between the gross and net domestic capital formation has been continuously widening which is indicative of the increasing rate of depreciation.

The cointegration test indicated that the series of saving (gross as well as net) and investment rates were characterised by the existence of a long-run and steady-state equilibrium relationship. The standard Granger causality test as well as the VAR model consistently evinced the existence of bi-directional causality between the rates of domestic saving and investment (both gross and net) in India. However, the results obtained from the Granger test adjusted for the error correction mechanism (ECM) indicated the existence of unidirectional causality running from the rate of domestic saving to the rate of investment (both gross and net). In view of the specification error associated with the standard Granger test (equations 9 and 10) and the presence of contemporaneous correlation between  $v(t)$  and  $u(t)$  in the VAR model, the results obtained from the Granger causality with ECM can be considered to be more tenable. In view of the unidirectional causality running from the rate of domestic saving to investment, the variations in the former reflect largely on the latter. Accordingly, the rate of domestic saving constrained the rate of investment and hence the pace of economic growth in India.

#### APPENDIX

The saving (S) alternatively represents the gross and net domestic saving, while the investment (I) has been measured in terms of the gross/net domestic capital formation. The rates of gross as well as net saving and investment (current) were computed as percentages of the gross/net domestic product at current market prices.

#### DEFINITIONS OF THE VARIABLES USED IN THE MODEL

Acronyms	Definition of the variable
1. RGS	: Rate of Gross Domestic Saving (per cent)
2. RNS	: Rate of Net Domestic Saving (per cent)
3. RGCF	: Rate of Gross Domestic Capital Formation (per cent)
4. RNCF	: Rate of Net Domestic Capital Formation (per cent)
5. T	: Time Trend

The prefix L with the variable indicates that the variable under reference has been taken in logarithmic terms.

#### NOTES

1. The Capital Certain and Return Risk-less Assets of the household sector have been classified to include deposits (banking and non-banking), social security funds (insurance fund and the provident and pension fund) and the net claims on government. The Capital Uncertain and Return Risky Assets include the household investment in the shares and debentures of the private corporate sector.

2. For equation (1) to be stable, we require  $|\beta| < 1$  and this can be mathematically proved. For this, consider a simple AR (1) model given by:  $Y(t) = \beta Y(t-1) + \mu(t)$  .... (1.1); where  $t = 1, 2, 3, \dots, n$ . Lagging equation (1.1) by one period, we have:  $Y(t-1) = \beta Y(t-2) + \mu(t-1)$  ... (1.2). Substituting equation (1.2) in equation (1.1), we have:  $Y(t) = \beta^2 Y(t-2) + \beta \mu(t-1) + \mu(t)$  .... (1.3). Repeating the same process, we get:  $Y(t) = \beta^3 Y(t-3) + \beta^2 \mu(t-2) + \beta \mu(t-1) + \mu(t)$  .... (1.4). It is apparent that if  $|\beta| > 1$ , then equation (1.4) will become explosive or unstable. Equation (1.1) is an illustration of autocorrelation in the variable Y, as distinct from the autocorrelation in errors.

3. In the regression specified by  $Y(t) = aX(t) + \mu(t)$ , the coefficient 'a' will, in general, not be equal to '1/b' in the regression equation specified by  $X(t) = bY(t) + \epsilon(t)$ . The difference in the estimates obtained from the set of both these Granger and Engle cointegrating regressions, can be interpreted as the difference arising from the sampling variance or as the genuine reflections of distinct equilibrium vectors.

In finite samples, the results obtained from the test are sensitive to the type of normalisation used, while such results remain asymptotically invariant to the normalisation problem.

4. Some Monte Carlo studies show that, in finite samples, there is a considerable bias in the parameter estimates obtained by the two-step method; see Banerjee, Dolado, Hendry and Smith [1986, Pp. 253-277] and Banerjee, Dolado, Galbraith and Hendry [1993]. The problem is less severe when the  $R^2$  of the cointegrating regression is near 1, indicating sufficiently large sample size.

5. The Final Prediction Error (FPE) for determining the appropriate order of 'p' for the restricted univariate autoregressive process and that of 'q' for the unrestricted bivariate system is given by:

$$FPE(p) = [(T + p + 1) / (T - p - 1)] [RSS(p) / T]$$

$$FPE(p, q) = [(T + p + q + 1) / (T - p - q - 1)] [RSS(p, q) / T]$$

where T indicates the number of observations, RSS: the residual sum of squares, p: the order of autoregressive process and q: the lag order of the additional independent variables of the bivariate representation.

6. For instance, in a regression specified by  $Y(t) = \alpha_0 + \alpha_1 X_1(t) + \alpha_2 X_2(t) + \alpha_3 X_3(t) + \xi(t)$ , the test can be carried out by simply regressing the OLS residuals  $\xi(t)$  on 1,  $X_1(t)$ ,  $X_2(t)$ ,  $X_3(t)$  and  $\xi(t-1)$ ,  $\xi(t-2)$ , ...,  $\xi(t-p)$ . The t-statistic of the individual coefficients of  $\xi(t-i)$  [ $i = 1, 2, 3, \dots, p$ ] which are asymptotically distributed as  $N(0, 1)$ , can be used to test the statistical significance of the i-th order serial correlation coefficient. To test that all the coefficients of the  $\xi(t-i)$  are jointly zero, we calculate the LM test statistic as:  $LM = T.R^2$ ; where T is the sample size and  $R^2$  is obtained from

the aforementioned regression of OLS residuals. This test is a joint test for not just the first, but for the first 'p' autocorrelations of  $\xi(t)$ .

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# THE POLITICAL ECONOMY OF POPULIST PROGRAMMES

G. Thimmaiah

*Populist programmes have been launched in the country both by the central and state governments. They have been introduced as redistributive strategies or for gaining political popularity, particularly during times of elections, or for meeting the provisions for the Scheduled Castes and Scheduled Tribes in the Constitution. While some of the programmes like providing foodgrains at subsidised prices to the poor have served the redistributive strategies, others like the waiver of agricultural loans have been a total disaster.*

## Background

The term 'political economy' was used by the classical economists like J.S. Mill to refer to the study of the determinants of production of wealth and its distribution in a society. Later this term came to be used by Marxists to explain the economic behaviour of social classes and the influence of production relations on the evolution of economic system. Today it is used to explain the interaction between the political power and economic behaviour of social classes. However the term 'populist programme' has become not only popular in newspapers and public conversation but has also acquired a pejorative overtone. But quite often even the enlightened leaders, well informed academics and bureaucrats have failed to understand the true meaning in its historical context.

Though the term 'populist programme' is all too familiar to us, still it is open to varying interpretations. This is partly because the range of populist programmes offered by political parties are numerous as well as diverse. For instance, on the one extreme all social welfare programmes which have been accepted as the legitimate responsibility of democratic governments can be called as populist programmes, whereas subsidised rice scheme intended to enable poor people to meet their minimum food requirements can be considered as a purely poverty alleviation programme. Consequently, some degree of value judgement becomes inevitable in identifying populist programmes. However, the degree of subjective judgement should be minimised to separate the grain from the chaff. This can be achieved by applying social relevance criterion to the specific programmes announced and implemented by the governments.

Even so, why do we call them populist programmes? How do we conceive and define them? More importantly, what is our perception of populist programmes? Are they bad or beneficial to the society? Do they serve any social purpose at all? Should the political parties be prevented from offering such programmes at the time of election? These are the questions which deserve dispassionate analysis.

In order to answer these questions, we have to first understand the (a) history of populist movements in the world, (b) logical foundations of political behaviour in democracy, (c) constitutional framework of Indian democracy, and (d) political economy of the Indian developmental experience. Once we understand these four dimensions, we will realise that there is a place for populist programmes in Indian democracy and also that the political parties should exercise caution while choosing such programmes.

## History of Populist Movements

The word 'populist' is an extension of the ideology of populism. The ideology of populism started as an anti-elitist movement in the U.S.A. and Russia during the nineteenth century [Miller, 1987, Pp. 393-394]. In the U.S.A. the urban elites took over the reigns of political power after the civil war. Many people did not like such passing of political power from the hands of rural elites to the urban oriented elite class. During the nineteenth and early twentieth centuries a large number of ordinary people experienced disruption of rural economic life as a consequence of far reaching technological changes. They became silent spectators of the process of political power passing out of their hand as a result of fast growth of non-agricultural economic activities. The rural

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masses could not adapt themselves to the changing power shift. Therefore, they started organising themselves as a countervailing force to recapture power from the urban elites. Such attempts were made in the U.S.A., Russia, Europe, Latin America and even in Asia. In the United States they organised what came to be known as the populist movement and founded a political party called 'People's Party'. 'People's Party' demanded government regulation of private economic activity, particularly railroads, and wanted a national agricultural policy with government subsidies to the farmers. This party wanted to restore the government power back to the representatives of the farmers in America. But this movement collapsed after its champion W. J. Bryan, a Democratic Presidential candidate, who was supported by People's Party was defeated.

In Russia, during the last decades of the nineteenth century, the young revolutionaries wanted the political power to be retained by the peasants and they romanticized the rural life as the true socialist communal life and many of them went to rural areas to live with the peasants. But this agrarian socialism did not catch the imagination of the Russian peasantry and as a result this early effort to give a populist shape to the socialist movement in Russia ended in disaster.

Even so the populist movement did not die completely as it was transformed into an appeal to the emotions of the people. The political parties started appealing to the sensitive and emotional issues concerning the people in general and some times to specific groups. These appeals were couched in criticism of the elites and some of these populist appeals were also directed against foreign immigrants. Such emotional appeals are heard even today in many countries. In fact, in America during the early decade of the twentieth century, the political populist movement assumed an extreme form of democracy where even legislations were proposed to be approved by popular referenda. Interestingly enough, the populist movement also started throwing up dictators in Europe, Latin America and Asia as the charismatic dictators started gaining power by appealing to the emotions of the masses. It was these dictators who started bribing the masses with targeted benefits - populist programmes.

#### *Rational Foundation of Political Behaviour*

Traditionally, the behaviour of political parties, political leaders and voters was analysed in terms of some normative principle, in the sense that the political philosophers suggested some vague moral code of conduct for the political institutions including political parties, political leaders, governments, bureaucrats and voters. They were expected to perform their duties in the best interest of the society and their main objective was prescribed as maximising the welfare of the entire society. This normative ideal was the standard measuring rod which was used to judge whether a particular government was good or bad, whether a party was good or bad, or even a policy was good or bad. While this moral code of conduct provided some sort of a lodestar for political parties, political leaders and governments in a democracy, it was inadequate to explain the reality of the situation and the true behaviour of the political parties, governments and voters. It was incapable of predicting the behaviour of political parties, governments and voters and, therefore, the usefulness of this normative approach came to be questioned. Attempts were also made to develop alternative approaches for the purpose of explaining and predicting political behaviour. Accordingly, a positive approach has been developed which has come to be known as Public Choice Approach. This approach tries to apply the logical foundations of the neo-classical micro-economic theory to the political behaviour of governments, political parties, bureaucracy and voters [Downs, 1957].

The neo-classical economic theory is founded on the principle that the consumer behaves rationally when he maximises his satisfaction, given his income and the prices of the commodities he wants to purchase. A rational consumer prefers higher satisfaction to lower satisfaction, higher income to lower income and lower prices to higher prices. In doing so the rational consumer is consistent in his preference ordering and does not alter the ordering of his preferences. Similarly, the producer attempts to maximise his profit given the input and output prices. This maximisation principle has come to be applied to the behaviour of governments, political parties

and voters in democracies. The market situations like competition, monopoly, duopoly and oligopoly have also come to be applied to political parties, governments and voters to explain the rationale behind the emergence of political alliances, pressure groups, political lobbies, political coalitions, etc. In a democracy, an individual voter may not be able to achieve much as he cannot influence a government or a political party single-handedly. So he forms a group or an association with other voters which becomes a pressure group. Examples are Farmers Associations, Caste Associations, Employees Associations, Linguistic Associations, etc. Such activities are considered as perfectly rational in terms of the maximisation principle. By applying these economic principles, the Public Choice Theory explains that the main objective of a government in power is to continue in power, and promoting social welfare is only a by-product. Similarly, the main objective of opposition political parties is to come to power. Likewise, the main objective of a voter is to maximise immediate and tangible benefits which he hopes to derive from different candidates and political parties by exercising his voting power. Thus, the political parties want to maximise votes to come to power and the voters want to maximise tangible benefits and minimise cost by choosing that political party which promises more benefits and least tax burden. This behaviour is considered as perfectly legitimate and rational in democracy. This theoretical analysis has been developed to a high degree of sophistication and an international journal called *Public Choice* has been published from the U.S.A. Though this Public Choice Theory was developed in Europe during the nineteenth century, it lost its prominence even in academic circles during the twentieth century. But the descendants of European migrants to America revived it and they have developed it into a high degree of sophistication. One of the founders of this Public Choice school is James M. Buchanan who won a Nobel Prize for his contribution to Public Choice theory. It is an important part of the Public Finance syllabi for post-graduate students in Economics all over the world.

The modern version of the populist movement has taken the form of some sections of the society forming themselves into self-interest pressure groups [Reisman, 1990]. The classic example is the trade union which organises workers to protect their economic interests. Such pressure groups have multiplied over the years and they are based on all possible criteria like caste, religion, occupation, language and what not! The main purpose of these pressure groups is to wield pressure or influence on the political parties, government in power, legislators, bureaucrats, etc., for the purpose of protecting their interests - economic, political and other interests - and also stalling any unfavourable decisions of the government in power which would adversely affect their interests. These pressure groups differ from organised political parties in that the scope of their activity is narrower as compared to the broad universal scope of the political parties. The main objective of pressure groups is to influence the government in power whereas the objective of the political party is to capture power. Some of the pressure groups differ from lobbies in that their activities include mostly influencing the government in passing a particular legislation or making a particular policy decision. Thus, it may be noticed that the concept of populist programme has something to do with the political parties and it has been used as a means of influencing some sections of the people and winning their support for capturing and/or retaining political power.

Though such activities are considered as legitimate and perfectly rational in terms of the Public Choice theory, Marxists do not accept them as legitimate because the Marxian ideology does not approve of any preference for particular sections of the society. Marxists maintain that democratic societies are divided into capitalistic class and working class, and their respective interests are not mutually consistent but conflicting. In such a situation the capitalistic class tries to use government to serve its own interests. In this process it has to legitimise the policies of the government which would create and foster its own class interest. Such legitimisation is done by developing legal institutions, laws and conventions which favour its own class interest. Consequently, all policies and programmes formulated and



implemented by such a government in capitalistic democracy, though they appear to be pro-poor, pro-worker and sometimes anti-rich, tend, in their actual operation and effect, to serve the capitalist class. Whenever governments in capitalistic democracies face threat to their position, they bribe the working class and the poor to rally their support. In this way, working class has come to be bribed by governments to give up the basic and radical social change. Thus, populist programmes are considered as open political bribery to buy peace and to prevent radical socio-economic changes through revolution.

#### *Constitutional Foundations of Populist Programmes*

Modern democracy is based on the principles of adult franchise and the rule of law. Every adult individual who is a citizen is given a vote to choose his political representative and he is free to exercise this franchise without fear or favour. The system of adult franchise was introduced into India through our Constitution. India of the 1950s inherited feudal vestiges originating from the institution of caste system, ownership of land and other property and, more importantly, unequal educational opportunities. All these factors were responsible for the unequal distribution of income and wealth. The resultant social and economic inequalities created a unique feudal society in India. In other words, the social and economic structures of the society were characterised by wide inequalities. These wide inequalities also gave rise to complex processes of exploitation of one section by the other, like the landlords exploiting the landless labourers, the upper caste people exploiting the lower caste people, men exploiting women, etc. In such an exploitative environment, the Constitution of India introduced democracy with equal voting power for all adult citizens. This was a unique event in the sense that the Indian Constitution superimposed political equality on the already existing economic and social inequalities. When this political equality was superimposed on economic and social inequalities, it sowed the seeds of conflict. It was in this context that Dr. B R Ambedkar observed: 'On the 26th of January 1950, we are going to

enter into a life of contradictions. In politics we will have equality and in social and economic life we will have inequality. ... We must remove this contradiction at the earliest possible moment or else those who suffer from inequality will blow up the structure of political democracy which this Assembly has so laboriously built up....' [Ambedkar, 1994, p. 1216].

The resultant conflicts were attempted to be resolved by making special provisions in the Constitution and through many amendments to the Constitution, creation of new institutions, government sponsored economic planning and by the latest strategy of populist programmes. Reservations in political representation under Articles 330, 332 and 334, as also under the Seventy-Third and Seventy Fourth Amendments to the Constitution, reservations in admission to educational institutions under Article 15(4) and reservations in government service under Article 16(4) and under Article 335 are all intended to ensure social justice. All these provisions have given rise to populist programmes in their actual implementation. It may be observed that populist programmes have come to be invented as a solution to the conflict of interests of different sections of the society.

Thus, populist programmes are not good or bad *per se* but will have to be judged in their right perspective of rational behaviour of political parties and voters. In fact, the very idea of government chosen by the people can itself be considered as a populist programme as compared to constitutional monarchy or Divine Kingship. If we leave voters free to vote for whatever party or whatever candidate they deem appropriate, we have no right to pass judgement on voters' choice. When we concede the point that in a democracy it is perfectly rational for any political party to aim at capturing power by using any legitimate method, it would be unfair to call its election promises or proposed programmes as populist in a pejorative sense. To do so involves a patronising value judgment. This is evident from the attempts of journalists who have tried to attach a pejorative meaning to populist programmes in this country. Suddenly they have become moral trend setters. But, unfortunately, the journalists have not bothered to analyse objectively the behaviour of

political parties, governments, bureaucracy and the voters. Objectivity is the least valued virtue of Indian thinking. Consequently, they have failed to recognise, let alone admire, the fact that poor people have rightly become a powerful pressure group in India.

### *Political Economy of Indian Development Experience*

It is very difficult to trace the origin of populist programmes in the Indian democracy. Probably they started with the first Congress government itself. Though the Congress government under the stewardship of Jawaharlal Nehru decided to launch upon government sponsored and public sector dominated economic planning for the development of the economy, they could not ignore certain earlier commitments of the Congress Party to the poorer sections of the society, like encouraging cooperatives, promoting village and cottage industries, protecting the interests of the weaker sections like Scheduled Castes (SCs) and Scheduled Tribes (STs). Though Mahatma Gandhi argued that we must pay more attention to rural development as a majority of the people lived in rural areas, Nehru did just the opposite. He paid more attention to industrial development through public sector enterprises and his policy was defended by most of the socialists. Even today some of us rightly think that his strategy was the most appropriate one for that time as otherwise India would have continued to remain as a Banana Republic even today. But in order to satisfy hard-core Gandhians, who were in majority in the then Congress Party, Nehru had to spend some money on village and cottage industries, cooperatives and the like. They were populist programmes judged in the context of big-industry oriented development strategy pursued by Nehru. But nobody called them populist programmes *vis-a-vis* long-term development plans of the country merely because they were all accepted by the Congress Party and also advocated by Mahatma Gandhi. But then, what is a populist programme and what is not?

Implicitly the critics of populist programmes expect that the government should spend and invest scarce funds on those long-term projects which will create assets and yield income for a long period of time to come and that income should be shared by a large number of people and not by a section as in the case of populist programmes. Thus, any responsible government should use scarce funds for building productive capacity in the economy and the fruits of such projects should be enjoyed by wider sections of the people and not by small groups. In contrast, the populist programmes would only benefit particular groups and sections of the society to whom they are specifically confined by excluding others from enjoying those benefits, and they are intended to attract votes for the political party which is promising these programmes. This explanation is fair enough. But it is very difficult to demarcate clear-cut boundary between populist programmes and long-term development programmes. Sometimes we find that some of the long-term development programmes have degenerated into cheap populist programmes and some of the highly criticised populist programmes have become socially beneficial to politicians and people. For example, indiscriminate entry of government into many economic activities, like hotels and airlines, has done more harm than good, whereas subsidised foodgrains distribution has really helped the poor. In other words, populist programmes can be conceived as redistributive programmes in a country like India. The distribution of income, wealth and other benefits tend to flow towards those persons and groups who are already better off. This is inherent in the operation of invisible market forces in the process of production and distribution. Such skewed distribution of income and wealth is considered to pose a threat to peace and harmony and even to the very foundations of democracy. Populist programmes were invented to redistribute income and other benefits from the small number of rich voters to a large number of poor voters. It has been accepted as the legitimate duty of the government to reduce inequalities through appropriate policies and programmes.

In the post-war era, the social scientists in developing countries as well as those employed

in international organisations debated this issue and arrived at an acceptable strategy of providing basic needs to the poorest in the developing countries along with pursuing the goal of achieving high rate of growth of GNP. This strategy was first mooted in the International Labour Organisation and it was passed on to the UN General Assembly for adoption. From then on the basic needs strategy has caught the attention of the planners in developing countries. The core of basic needs approach to development is that while the poor people in developing countries have waited in vain for too long expecting benefits of growth to trickle down into their hands, they can not be expected to wait any longer. Therefore, the poor should be provided with physical basic needs like food, clothing, shelter, medical facilities and cultural basic needs like education, clean environment and democratic institutions to enable them to lead a decent life. However, though the governments of developing countries agreed with this approach, they did not actually implement it immediately for various reasons, the prominent reason being the resource crunch.

In India, the Indian planners were excessively optimistic about eradicating poverty through government sponsored economic development programmes. The experience of the first phase of Indian planning which extended from 1951-52 to 1960-61 may be summed up as an experiment in 'blind optimism'. This period was characterised by the objective of maximising growth of per capita income through big industries strategy. The failure of this strategy was evident even by mid-1960s. Therefore, during the second phase of the Indian planning regime, which lasted from 1960-61 to 1968-69, the Indian planners realised the 'grim realities' of the operation of a mixed economy. The planning efforts created economic infrastructure facilities which benefited the private sector much more than the masses. This, no doubt, softened the opposition of private sector to the government sponsored economic planning which was very vocal during the first phase. But the private sector started manipulating policy decisions of the government to its own advantage. It was from this period that private sector rent seeking activity increased. In the third phase, a

study sponsored by the Ford Foundation on poverty in India created a national awareness about the extent of absolute poverty. The past failure to keep tall promises made by the planners and the political leaders coupled with the political instability which started at the end of 1960s and the split in the Congress Party paved the way for national level populist programmes for capturing political power. The masses started searching for new leadership to deliver the goods. It was on the crest of that mass upsurge that Mrs Indira Gandhi emerged as a saviour of the poor and the oppressed. She coined a populist slogan, *Garibi Hatao*, promising to drive out poverty. With this slogan the politics of poverty acquired prominence in India. The political leaders, including Mrs Indira Gandhi, started playing with the politically explosive issues like poverty of the masses. Only those at the grass-root level who were prepared to support Mrs Indira Gandhi were given the crumbs; the rest of the poor were ignored for their 'reactionary' attitude. The period of the Fourth Plan was preoccupied with this debate on the failure of planning to reduce poverty and the alternative schemes and programmes required to help the poor people. Ultimately, the Indian planners accepted the UN General Assembly Resolution to ensure the basic needs to the poor people. This resulted in the formulation of minimum needs programme during the Fifth Plan period. Though the planners were convinced that the Five Year Plans failed to help the poor, they tried to meet the basic needs of the poor through providing essential collective public services rather than providing food and clothing which were the most basic needs of the poor people in India. The restricted minimum needs programme included elementary education, adult education, rural health, rural water supply, rural roads, rural electrification, sites for rural labour households, environment, health and nutrition. The planners assumed that employment and income generated through development schemes and projects will enable the poor people to purchase adequate food and clothing and, therefore, the planners' responsibility was only to provide certain minimum social consumption goods to improve the

quality of their life. It was this assumption which failed to materialise and led to multiplication of populist programmes at the state level. This became inevitable because the state governments were very near to the voters and the majority of the voters did not benefit from the development programmes of the country. Their political representatives once elected did not bother to redress their grievances. This made the voters as much selfish as the political leaders and started responding to the political parties which promised them direct and immediate tangible benefits.

In India, it is very difficult to identify whether the central government started the populist programmes first or the state governments attempted them first. The Constitution prescribed the mandate for the Government of India to promote the welfare of the SCs/STs. In pursuance of this mandate, the Government of India started formulating social welfare schemes and entrusted the responsibility of their implementation to the state governments. Subsequently, under the Five Year Plan regime many more social welfare as also some social security schemes were launched. These schemes have been implemented on a continuous basis. The state governments also designed and implemented their own welfare schemes. The magnitude of expenditure by the state governments on these social welfare and social security programmes which has increased in recent years is presented in Table 1. It may be observed that Tamil Nadu government tops the list in spending on social welfare and social security programmes. This is the outcome of social reform movements which dominated the political scene of Tamil Nadu. However, a few other states, like Karnataka, Bihar, Uttar Pradesh, Madhya Pradesh and Maharashtra have also spent on these programmes. This would imply that weaker sections have been able to wield influence on the state governments to spend more on social welfare programmes. This should be considered as a positive political development in an unequal society.

A careful examination of the central and state

budgets over the years reveals that both the central and the state governments have resorted to competitive populism. It has gone to the extent of the central government sometimes attempting to plagiarise the populist schemes introduced by state governments by copying and converting these into centrally sponsored schemes.

For example, in Karnataka, Congress-I government headed by Shri Devaraj Urs started a scheme under which one free light was given to a Scheduled Caste household in every village. The central government copied this in 1989-90 in the name of *Kuir Jyothi* scheme which is nothing but a carbon copy of the Karnataka scheme. Similarly, the Janata Government in Karnataka headed by Shri Ramakrishna Hegde introduced *Ganga Kalyan* scheme. This was copied by the central government in 1988-89. Yet another scheme is Hut Fire Insurance Scheme for agricultural labourers, also introduced by Shri Ramakrishna Hegde in Karnataka. Under this scheme those agricultural labourers who lose their huts in fire accident will receive some compensation. The central government introduced similar scheme as a centrally sponsored scheme. It posed a serious problem for the state government officers as they had to implement both the schemes which were overlapping. This is one form of competitive populism which is being indulged in by the central and the state governments.

But the state governments themselves have been competing with each other in introducing populist programmes. For instance, Tamil Nadu government exempted farmers from paying electricity charges for the use of electricity for irrigation pump sets. This was copied by the Congress-I government led by Shri R Gundu Rao in Karnataka and all the successive governments in Karnataka have continued this scheme with disastrous consequences on the finances of the Karnataka State Electricity Board. Andhra Pradesh government which copied this populist programme has luckily reversed it and started introducing some nominal charges.

TABLE 1. STATE GOVERNMENTS' EXPENDITURE ON SOCIAL SECURITY AND WELFARE PROGRAMMES

State	Revenue Account						Capital Account						(Rs lakh)
	1991-92	Per cent of Total Rev- enue Expen- diture	1992-93 (RE)	Per cent of Total Rev- enue Expen- diture	1993-94 (BE)	Per cent of Total Rev- enue Expen- diture	1991-92	Per cent of Total Cap- ital Expen- diture	1992-93 (RE)	Per cent of Total Cap- ital Expen- diture	1993-94 (BE)	Per cent of Total Cap- ital Expen- diture	
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)
1. Andhra Pradesh	10,710	1.66	11,476	1.60	13,039	1.61	887	0.66	733	0.41	233	0.14	
2. Arunachal Pradesh	285	0.99	390	1.15	347	0.87	-	-	-	-	-	-	
3. Assam	2,898	1.35	4,337	1.77	4,246	1.52	28	0.04	33	0.05	25	0.03	
4. Bihar	17,056	2.97	19,504	2.97	21,731	2.97	58	0.05	2	0.02	65	0.06	
5. Goa	678	2.04	685	1.80	695	1.59	15	0.11	50	0.42	33	0.25	
6. Gujarat	11,993	2.29	14,860	2.39	16,356	2.49	87	0.05	89	0.05	124	0.07	
7. Haryana	11,648	5.12	13,967	5.87	16,822	4.76	104	0.23	146	0.25	57	0.08	
8. Himachal Pradesh	2,080	2.12	2,333	2.04	2,444	1.82	14	0.01	26	0.09	32	0.54	
9. Jammu & Kashmir	8,872	5.83	7,737	4.34	5,109	2.84	267	0.35	404	0.75	448	0.20	
10. Karnataka	21,168	4.27	21,896	3.92	21,645	3.35	308	0.25	375	0.25	378	0.07	
11. Kerala	7,075	2.20	9,138	2.50	9,662	2.19	37	0.05	35	0.05	62	0.79	
12. Madhya Pradesh	7,715	1.42	13,129	2.13	14,941	2.03	1,544	1.25	1,398	0.93	1,159	0.06	
13. Maharashtra	18,230	1.81	24,805	2.15	25,362	1.97	94	0.05	238	0.10	186	0.02	
14. Manipur	632	1.67	889	2.23	947	2.25	9	0.05	5	0.01	5	-	
15. Meghalaya	490	1.33	720	1.75	904	1.75	-	-	-	-	-	-	
16. Mizoram	659	2.05	20	0.05	494	1.14	-	-	-	-	-	-	
17. Nagaland	943	1.93	920	1.75	926	1.36	9	0.06	29	0.09	-	-	
18. Orissa	8,030	3.05	13,876	4.55	13,696	3.66	30	0.03	65	0.08	39	0.04	
19. Punjab	6,959	1.66	7,417	2.17	7,826	1.89	90	0.11	-	-	-	-	
20. Rajasthan	4,815	1.18	6,488	1.33	7,657	1.31	41	0.02	12	0.01	11	0.01	
21. Sikkim	228	1.47	214	1.19	251	1.26	1	0.01	-	-	-	-	
22. Tamil Nadu	39,652	4.57	49,266	5.77	51,607	6.14	121	0.11	94	0.08	22	0.02	
23. Tripura	1,957	3.57	2,077	3.77	1,830	2.90	10	0.08	14	0.13	18	0.13	
24. Uttar Pradesh	15,710	1.51	17,217	1.36	18,065	1.31	147	0.05	69	0.02	25	0.01	
25. West Bengal	8,374	1.57	12,577	2.22	13,535	1.92	-	-	-	-	-	-	
All States	208,857	2.59	256,638	2.67	270,137	2.47	3,901	0.17	3,817	0.17	2,922	0.11	

(Contd.)

TABLE 1. (CONCLD.)

State	(1)	(2)	Total (Revenue and Capital) Expenditure						(Rs lakh)
			1991-92	Per cent	1992-93 (RE)	Per cent	1993-94 (BE)	Per cent	
	(3)	(4)	(5)	(6)	(7)	(8)			
1. Andhra Pradesh	11,597	1.49	12,209	1.36	13,272	1.36			
2. Arunachal Pradesh	285	0.63	390	0.78	347	0.60			
3. Assam	2,926	1.05	4,370	1.39	4,271	1.18			
4. Bihar	17,114	2.52	19,506	2.52	21,796	2.58			
5. Goa	693	1.46	735	1.47	728	1.28			
6. Gujarat	12,080	1.74	14,949	1.87	16,480	1.99			
7. Haryana	11,752	4.30	14,113	4.77	16,879	3.97			
8. Himachal Pradesh	2,094	0.90	2,359	1.63	2,476	1.46			
9. Jammu & Kashmir	9,139	4.00	8,141	3.51	5,557	2.14			
10. Karnataka	21,476	3.46	22,271	3.14	22,023	2.64			
11. Kerala	7,112	1.76	9,173	2.10	9,724	1.84			
12. Madhya Pradesh	9,259	1.39	14,527	1.90	16,100	1.82			
13. Maharashtra	18,324	1.51	25,043	1.79	25,548	1.61			
14. Manipur	641	1.17	894	1.09	952	1.52			
15. Meghalaya	490	1.02	720	1.39	904	1.24			
16. Mizoram	659	1.58	720	1.66	494	0.89			
17. Nagaland	952	1.47	949	1.40	926	0.99			
18. Orissa	8,060	2.22	13,941	3.73	13,735	2.88			
19. Punjab	7,049	1.40	7,417	1.79	7,826	1.46			
20. Rajasthan	4,856	0.84	6,500	1.11	7,668	1.04			
21. Sikkim	229	1.00	214	1.07	251	0.90			
22. Tamil Nadu	39,773	4.05	49,360	5.87	51,629	5.40			
23. Tripura	1,967	2.90	2,091	3.31	1,848	2.40			
24. Uttar Pradesh	15,857	1.18	17,286	1.26	18,090	1.05			
25. West Bengal	8,374	1.33	12,577	1.79	13,535	1.65			
All States	212,758	2.07	260,455	2.12	273,059	2.03			

Source: RBI Bulletin (various years), Reserve Bank of India, Bombay.



Another populist scheme which has spread from Maharashtra to other states is the loan waiver scheme. Maharashtra government introduced it in 1980. Tamil Nadu government copied it in the same year and it spread to Madhya Pradesh and Haryana in 1984 and 1987. Again, and what is worse, this loan waiver scheme was copied by the National Front Government at the Centre in 1991-92 which made it a national populist scheme. Similarly, interest-on-loan waiver scheme was started by Maharashtra in 1979 and it was copied by the Government of India in 1980. Karnataka government also copied it and ever since that time it has been implemented repeatedly in Karnataka. This is how the state governments themselves have been copying as well as competing in introducing populist programmes in India. A list of such schemes introduced in Karnataka and their intended beneficiaries is presented in Table 2.

Populist programmes include both political and economic programmes ranging from a major programme of reservation policy to a minor and insignificant programme like *Thali Bhagya* (free *Mangal Sutra* to newly wedded couples belonging to certain sections of the society). The political populist programmes sometimes take the shape of ideological movements like Zamindari abolition and land to the tiller. Some political populist programmes also become emotionally sensitive movements like promising to reserve major portion of jobs for sons of the soil. Instead of narrating about innumerable programmes, it may be useful to concentrate on two important populist programmes which are economic in nature and content. With a view to providing contrasting illustrations by evaluating the beneficial as well as harmful economic effects of populist programmes, I have evaluated a programme which has become a beneficial programme and another which has become a disastrous populist programme. The populist programme which can be justified on economic as well as on non-economic grounds and which has benefited the poorer sections of the society is the subsidised rice scheme. In contrast, another populist programme which has resulted in disastrous economic consequences is the loan waiver scheme.

#### *Subsidised Rice Scheme*

Subsidised Rice Scheme has become a politically powerful as well as controversial populist programme in India. Since rice is the staple food of a majority of South Indians, the availability of rice at affordable price has become a major public policy issue in Southern India. The recent defeat of the Congress Party in Andhra Pradesh has been attributed to Mr. N.T. Rama Rao's election promise of reviving his earlier subsidised Rs 2 per kg rice scheme. The commentators have only bothered to highlight the financial burden that such a policy would impose on the state government. They have not cared to analyse the reason for the voters of Andhra Pradesh taking the risk of accepting such a programme and voting Mr. N.T. Rama Rao and his Telugu Desam Party to power. In Karnataka also the Janata Dal Party's supplementary manifesto contained a promise of supplying subsidised rice at Rs 3.20 per kg to the poorer sections of the ration card holders. Though the financial implication of this scheme is hardly about Rs 220 crore, the Janata Dal government has decided to implement it only from 1st April, 1995, whereas Mr. N.T. Rama Rao has already implemented his Rs 2 per kg rice scheme from January 1, 1995, in spite of the fact that his scheme would cost the exchequer about Rs 1,200 crore per annum. Even Naidu's government which replaced N.T. Rama Rao has promised to implement this programme.

It may be mentioned in this context that providing food to the people facing hunger has been considered as the responsibility of modern governments in all civilised societies. Even the British colonial rulers arranged for the supply of gruel to the people in times of famines and the Famine Commissions appointed by the British Government justified such public feeding arrangements on humanitarian ground. During the Bengal famine this system could not be operated on a required scale. Consequently, lakhs of people perished from hunger. After Independence, there have been stray cases of poor people in remote places dying of hunger. Food is an

TABLE 2. POPULIST PROGRAMMES INTRODUCED DURING THE 1980S AND 1990S IN KARNATAKA

Populist Scheme	Year of Introduction	Introduced by	Intended Beneficiaries	Nature of Benefit Provided	Amount of Expenditure Involved
(1)	(2)	(3)	(4)	(5)	(6)
1. BHAGYA JYOTHI (Lucky Light)	April, 1979	Sri S M Yahya, Finance Minister (Congress-I Govt.)	A few houses occupied by the poorest families	Provided with one bulb connection free of cost and free of electricity charge	NA
2. SAGARA DEEPA (Ocean Light)	1980	Sri Veerappa Moily, Finance Minister (Congress-I Govt.)	Traditional Fishermen	50% interest subsidy for loans granted to the marine and inland sector	NA
3. NEGILU BHAGYA (Lucky Plough)	August, 1982	Sri Veerappa Moily, Finance Minister (Congress-I Govt.)	Families to whom surplus land was distributed and tenants on whom occupancy rights were conferred under land reforms	Assistance ranging from Rs 1,000 to Rs 1,500 was given to enable them to purchase bullocks, agricultural implements & other goods and 14,300 persons were reported to have benefited	NA
4. ANTHYODAYA (Dawn of End)	1983-84	Sri Ramakrishna Hegde, Chief Minister (Janata Dal Govt.)	Uplifting of the five poorest families in every village in 56 selected taluks of Karnataka	37,000 families were claimed to have been benefited	Rs 2.67 crore
5. RURAL DRINKING WATER SUPPLY	1983-84	"	Rural People	To provide safe drinking water to rural people	Rs 76.4 crore (during 1983-85)
6. ASHA KIRANA (Ray of Hope)	April, 1983	Sri Veerappa Moily, Finance Minister (Congress-I Govt.)	Modified version of the earlier <i>Beedi Bhagya</i> Scheme to provide compensation to the injured workers in the unorganised sectors such as hawkers, hamalis, construction workers, etc.	NA	Rs 1 crore
7. OLD AGE PENSION	1983-84	Sri Ramakrishna Hegde, Chief Minister (Janata Dal Govt.)	All destitute persons aged 65 years and above	Rs 50 per month. 5.3 lakh persons reported to have been benefited (now it is Rs 75 p.m.)	Rs 107 crore
8. PENSION TO DESTITUTE WIDOWS	April 1984	"	Destitute widows who were not supported by relatives and whose income did not exceed Rs 1,500 per year	Rs 50 per month (now it is Rs 75 p.m.) 65,770 women were reported to have been benefited	NA
9. FINANCIAL ASSISTANCE TO PHYSICALLY HANDICAPPED	April 1984	"	Physically handicapped persons whose family income did not exceed Rs 3,500 per year	Rs 50 per person per month (now it is Rs 75 p.m.)	Rs 2.04 crore

(Contd.)

TABLE 2. (CONTD.)

Populist Scheme	Year of Introduction	Introduced by	Intended Beneficiaries	Nature of Benefit Provided	Amount of Expenditure Involved
(1)	(2)	(3)	(4)	(5)	(6)
10. MATERNITY ALLOWANCE	April 1984	Shri Ramakrishna Hegde, Chief Minister (Janata Dal Govt.)	Landless agricultural labourers during advance pregnancy period	Rs 300 per annum	NA
11. HALLI HEDDARI (Village Approach Road)	1984-85	"	Roadless villages and hamlets which have a population of 1,000 and cannot be covered under any other schemes	408 villages to be covered in the first phase	Rs 47.25 during 1984-85
12. GANGA KALYANA	April 1984	"	SCs/STs/BCs engaged in agriculture	25% of the cost of irrigation well as subsidy and constructing community irrigation wells	Rs 1 crore
13. THALI BHAGYA	August 1985	"	Poor families	<i>Thali</i> worth Rs 350 or <i>Mangalasutra</i> weighing one gram of 22 carat gold, 1 pair of dhoti and 1 pair of saree with blouse. In weddings where <i>Thali</i> is not used an amount of Rs 200 was given to people in the form of NSCs	NA
14. DISTRIBUTION OF TEXT BOOKS TO SCHOOL CHILDREN	1985-86	"	School going children of poor families	Text books to school children studying up to 7 std., in Govt., Corpn. and aided schools	Rs 3.92 crore in the first year
15. SUBSIDISED RICE	Nov. 1, 1985	"	Families whose annual income is below Rs 3,500	Supply of rice and ragi at subsidised rates. 23,93,212 families were reported to have been benefited	NA
16. JANATA SAREES & DHOTIS	Oct. 2, 1985	"	All persons belonging to families whose annual income was below Rs 500. Those who were eligible for subsidised rice were made eligible	A set of a dhoti and shirt per Rs 15 and a set of saree and blouse at Rs 12.50	NA

(Contd.)

TABLE 2. (CONTD.)

Populist Scheme	Year of Introduction	Introduced by	Intended Beneficiaries	Nature of Benefit Provided	Amount of Expenditure Involved
(1)	(2)	(3)	(4)	(5)	(6)
17. FREE UNIFORMS TO SCHOOL CHILDREN	1985-86	"	All school children studying in I & II standards in Govt., Corpn. & aided schools were provided with free uniforms with two sets each. In case of girls belonging to SC/ST it was extended up to 7th std.	21 lakh students were reported to have been benefited in 1985-86.	Rs 12.58 crore
18. WRITING OFF FARMERS' LOANS	April, 1986	"	Farmers' in the drought prone areas to reduce their debt burden		NA
19. VISHWA (Universe)	2 Oct, 1991	Sri S Bangarappa, Chief Minister (Cong-I Govt.)	Self-employment schemes for youth	Construction of common facility centres, textiles, handicrafts, etc.	Rs 10 crore in 1991 and 75 crore in 1992-93
20. SUSHRUSHA (Treatment)	July, 1991	"	Economically weaker sections of the society	Provide community health check-up to diagnose major diseases. 4,000 lakh people were examined.	NA
21. ASHRAYA (Shelter)	April, 1992	"	Housing for the Poor	Construction of about 2,60,000 houses	Budget Provision Rs 163.32 crore
22. ARADHANA (Worship)	April, 1992	Sri Veerappa Moily, Finance Minister (Cong-I Govt.)	Collective	To repair places of worship including those belonging to minor communities also	Rs 5 crore during 1992-93 & Rs 6 crore during 1993-94
23. AKSHAYA (Inexhaustible vessel)	Nov. 1991 actually April, 1992	Sri S Bangarappa, Chief Minister (Cong-I Govt.)	Cash incentive scheme for the families of poor children of 1-4 th std. studying in government schools	Expected to cover 30 lakh children	Rs 47.5 crore during 1991-92 Rs 80 crore during 1992-93
24. SHRAMA KALYANA NIDHI (Workers' Welfare Fund)	April, 1992	"	Agricultural labourers	To ensure minimum standard of living to promote their welfare	Rs 5 crore during 1992-93
25. RUDRABHOOMI	April, 1992	"	Villages without burial grounds	Acquisition of suitable land for burial grounds	Rs 1 crore 1992-93
26. UDYOG JYOTHI (Light of Employment)	April, 1993	Sri Veerappa Moily, Chief Minister (Congress-I Govt.)	Poorer sections of the society	To provide income-generating assets worth Rs 1,500 per beneficiary	Rs 2.25 lakh during 1994-95

(Contd.)

TABLE 2. (CONCLD.)

Populist Scheme	Year of Introduction	Introduced by	Intended Beneficiaries	Nature of Benefit Provided	Amount of Expenditure Involved
(1)	(2)	(3)	(4)	(5)	(6)
27. NERALINA BHAGYA (Lucky Shadow)	April 1993	"	Families in rural areas with thatched houses	Assistance up to Rs 3,000 to enable them to have tiled roof	NA
28. INTEREST WAIVER ON CROP LOANS	March 1995	Sri Siddaramaiah, Finance Minister (Janata Dal Govt.)	All farmers	To provide relief as also to encourage repayment of crop loans	Rs 130 crore 1995-96
29. SUBSIDISED RICE	March 1995	"	Poor sections of society	To protect the poor people from the adverse effects of inflation	Rs 220 crore during 1995-96
30. HEALTH FUND FOR THE POOR	March 1995	"	Needy poor suffering from fatal diseases	To provide free treatment to poor people	Rs 10 crore
31. SWASHAKTI (Self-Reliance)	March 1995	"	Destitute widows and other disempowered women	Imparting skills for self-employment	NA

Sources: (a) Budget Speeches of Finance Ministers of Karnataka.

(b) Government of Karnataka, *Promises and Performance*, (A publication of Information Department).

essential basic need of all human beings. Therefore, it is necessary to see that adequate foodgrains are available and accessible to all people, particularly to the poor. It is necessary to recognise the fact that mere availability will not ensure accessibility to the poor. Poor people require purchasing power or monetary entitlement to purchase foodgrains. Even when adequate foodgrains are available in the market, if poor people do not have adequate income, given the prices of foodgrains, then they face hunger. Therefore, it has become the responsibility of the governments in power to ensure not merely adequate availability of foodgrains in the market but also at affordable prices for the poor people. This is the core of the subsidised rice scheme in India.

India evolved a scheme of foodgrains rationing during the Second World War, compulsorily requisitioned and distributed among the needy people in limited quantities at reasonable prices. This rationing system was continued even after the Second World War and subsequently it was converted into a sort of food security system in the name of Public Distribution System (PDS).

Under the Public Distribution System, the Food Corporation of India and the state governments' Food and Civil Supplies Departments procure foodgrains from the farmers and millers and build buffer stocks from which foodgrains are drawn for supply to the ration card holders at the state level. But the PDS took a long time to evolve into an effective food security programme. Until the 1970s it was mainly confined to the urban areas. The rural poor faced shortage of foodgrains, particularly in times of drought and crop failure. There were many inadequacies in the operation of the PDS even in urban areas, such as inadequate and untimely supply, supply of poor quality foodgrains, leakage of the PDS articles to the open market, etc. The poor people in the rural areas did not have even such inefficient Public Distribution System. They were exposed to deprivation. It was against this background that subsidised rice scheme was thought of by Shri C.N. Anna Durai, then leader of the Dravida Munnetra Kazhagam (DMK). In the 1967 Assembly elections in Tamil Nadu, he promised to supply rice at 66 paise per kg.

It should be remembered in this context that

mid-1960s was a very bad period for the Indian economy. There was severe drought as a result of total failure of rains in 1966 and 1967. Prices started sky-rocketing and the rationing system continued to serve mainly the urban areas in meeting the food needs of the people. On top of it, there was an overall shortage of foodgrains in the country which forced the Indira Gandhi government to agree for devaluation of the Indian Rupee for getting PL-480 wheat from America. Realising the plight of the poor people, the DMK Party formulated their populist programme strategy in the 1967 Assembly elections, promising to supply cheap rice in the statutorily rationed cities of Madras and Coimbatore at 66 paise per kg and supply of subsidised wheat for promotion of change in food habits. Though Shri Anna Durai promised to supply rice at 66 paise per kg, this scheme went unnoticed.

Shri Anna Durai did implement this scheme without much difficulty. Subsequently, in the 1970s, Mr. Karunanidhi extended this programme to rural areas at the rate of one rupee a measure. However, this scheme was discontinued after some time because of the financial burden it imposed on the state budget, apart from the price disincentive which it was reported to have created for the farmers.

The Telugu Desam Party promised in 1983 that it would supply rice at Rs 2 per kg. Here again we have to understand the background, against which this scheme was announced, in order to appreciate the usefulness of this scheme. Mr. K.R. Venugopal who studied the food security system in India and the subsidised rice scheme in Andhra Pradesh observed that 'In a way, Andhra Pradesh reflects the conditions obtaining in India as a whole at the macro level, with large stocks of surplus foodgrains and vast masses of population going hungry - a situation crying out for a solution by which the surplus stocks could be used to feed the hungry' [Venugopal, 1992, p. 168].

It may be mentioned in this context that even before the 1983 Assembly elections, the Congress Party government in Andhra Pradesh had also promised to distribute subsidised rice through the PDS at prices ranging from Re 1 per kg for common variety, Rs 2 per kg for fine variety and Rs 2.50 per kg for superior variety. From this we

may infer that the promise to supply rice at Rs 2 per kg by the Telugu Desam Party was not a great populist programme, as rice was supplied through the PDS at a more or less comparable price. It may be mentioned in this context that average price of moderate variety of rice increased from 40 paise per kg in 1954-55 to only 77 paise per kg in 1964-65. But during 1970s it increased very sharply to Rs 1.78 per kg in 1977-78 and by mid-1980s it was more than Rs 3 per kg. This may be observed from Table 3. Thus, poor people were adversely affected by this sharp increase in the price of rice. But what was important at that time was that a major portion of the rice was distributed through the PDS only in urban areas. For example, about 35 per cent of the PDS rice was distributed in Hyderabad and Visakapatnam. In Hyderabad city itself, a ration card holder was entitled to 50 kg of rice per month. But similar benefits were not available in the rural areas partly because adequate quantities of rice was not released to the state from the Central Pool. Therefore, the rural people did not benefit much from the PDS before the TDP came to power in Andhra Pradesh. The TDP noticed this lacuna in that particular situation and decided to use it to its advantage. It was a typical example of political entrepreneurship. It promised to provide 10 kg of rice at Rs 2 per kg to all the poor households, and subsequently, this quota was raised to 25 kg for poor households. The rural poor households were then identified as those whose annual income was only Rs 3,600 per annum. The TDP government revised it upwards to include all those rural households who had annual income of Rs 6,000. This required substantial stock of foodgrains which the TDP government managed to mobilise and distribute. It is also necessary to remember that the PDS was streamlined by the TDP government in Andhra Pradesh. The leakage indulged in and the indifference shown by the fair price shop owners towards the poor were minimised. Earlier, poor people were forced to purchase the entire quota of rice in the first week of every month. But many of them were daily wage earners who could not mobilise so much money in the first week of every month. The TDP government modified this monthly distribution and allowed the rural poor to purchase their quota of subsidised rice in four

instalments in a month. This made the task easy, thereby matching their income flow to the purchase of rice. Thus, the TDP government's Rs 2 per kg rice scheme was not a populist scheme in the pejorative sense. It was a scheme introduced to provide rice through the PDS to the rural poor. Even the staunch critics of the TDP government would admit the fact that the TDP reached the

rural poor through the PDS rice scheme. Hunger was reduced. Since food was the basic need of the poor people, no sensible person would say that it was a populist programme. It was no fault of the poor people who obviously voted for that party which provided them cheaper food through subsidised rice scheme.

TABLE 3. PRICES AND PRICE INDICES OF RICE, WHEAT AND OTHER CEREALS

NSS Round	Survey Period	Average Price (Rs per kg)			Index Number of Prices (Base: NSS 8th & 9th Rounds)		
		Rice	Wheat	Other Cereals	Rice	Wheat	Other Cereals
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
8	July 1954 - March 1955	0.40	0.40	0.24	98.00	111.00	104.00
9	May - November 1955	0.42	0.34	0.21	102.00	94.00	91.00
8 & 9	July 1954 - November 1955	0.41	0.36	0.23	100.00	100.00	100.00
13	Sept. 1957 - May 1958	0.56	0.44	0.33	137.00	122.00	143.00
15	July 1959 - June 1960	0.56	0.47	0.39	137.00	131.00	170.00
18	Feb. 1963 - Jan. 1964	0.64	0.47	0.36	156.00	131.00	157.00
19	July 1964 - June 1965	0.77	0.66	0.50	188.00	183.00	252.00
27	Oct. 1972 - Sept. 1973	1.38	1.03	1.01	337.00	286.00	439.00
28	Oct. 1973 - June 1974	1.81	1.39	1.23	441.00	386.00	535.00
32	July 1977 - June 1978	1.78	1.31	1.16	434.00	364.00	504.00
42	July 1986 - June 1987	3.24	2.13	1.89	791.00	592.24	822.46
43	July 1987 - June 1988	3.53	2.32	2.00	862.00	644.40	871.31
44	July 1988 - June 1989	3.87	2.59	2.16	942.84	719.99	937.30
45	July 1989 - June 1990	4.04	2.56	2.24	986.52	710.99	975.97

Source: 1. Bhattacharya, Nikhilesh, *et al* (1991), *Poverty, Inequality and Prices in Rural India*, Sage Publications, New Delhi.  
2. Suryanarayana M.H. *Methods of Poverty Estimates: A Critical Survey*, (Monograph), p. 17.

Two evaluation studies have been conducted on the TDP government's Rs 2 per kg rice scheme in Andhra Pradesh. One by Radhakrishna and Indrakanth [1991] and another by Venugopal [1992]. These studies have shown that the scheme did really help the poor by reducing their hunger and increasing the nutritional standard of the poor people. Radhakrishna and Indrakanth observe that 'Of special interest is the positive effect of two-rupee-a-kilo scheme on the consumer welfare levels of the poor and middle class of rural areas and the negative effect on the consumer welfare levels of the rural and urban rich classes. There is no change in the welfare levels of the poor and middle classes of the urban areas because they are covered under the ration system even after the withdrawal of the existing rice scheme, as it was prevailing prior to the rice scheme. The poor will improve their per capita rice intake by 8.7 per cent and per capita expenditure by 6.79 per cent. The corresponding

improvement for the middle class is 2.42 per cent and 4.23 per cent, respectively. Clearly, the rice scheme results in a welfare transfer from the rural rich classes to the rural poor classes. It allows more egalitarian distribution of basic food' [Radhakrishna and Indrakanth, 1991, p. 101].

Radhakrishna and Indrakanth also carried out a few simulation exercises on the effects of this Rs 2 per kg rice scheme on the output of rice, producer and consumer prices, and the financial burden on the budget as also on the long term investment projects, like irrigation. They found that the direct benefits of major irrigation projects were limited to a small segment of peasants and it did not adversely affect supply of domestic output or aggregate consumption of rice, though it affected the consumer and producer prices. They only suggested fine targeting of the scheme to reduce the budgetary expenses.



TABLE 4. STATE-SPECIFIC SHARES IN INDIA'S CEREALS OUTPUT AND TOTAL REPORTED HOUSEHOLD CONSUMPTION IN 1983 AND 1987-88, STATE-WISE SHARES TO PDS IN REPORTED CEREALS CONSUMPTION IN 1983 AND 1987-88 AND STATE-WISE RATES OF GROWTH OF CEREALS OUTPUT AND CONSUMPTION OVER PERIOD 1983 TO 1987-88

(Per cent)

Sl. No.	Name of the State	Share in All-India Cereals Output in Year		Rate of Growth of Cereals Output over 1983-88	Share in Reported Cereals Consumption in year		Rate of Growth of Cereals Consumption over 1983-88	Share of PDS in Reported Cereals Consumption in year	
		1983	87-88		1983	87-88		1983	87-88
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
1.	Andhra Pradesh	8.20	7.14	-17.00	8.10	7.73	1.96	13.15	14.03
2.	Assam	1.95	2.19	7.27	2.94	3.04	10.43	15.42	21.44
3.	Bihar	6.27	6.83	3.81	11.32	11.38	7.46	6.70	7.65
4.	Gujarat	3.65	0.95	-75.26	4.14	4.04	4.40	5.82	28.67
5.	Haryana	4.74	4.78	-3.84	1.90	2.01	12.71	6.46	7.79
6.	Himachal Pradesh	0.88	0.67	-27.63	0.70	0.72	9.12	9.36	17.60
7.	Jammu & Kashmir	0.83	0.76	-13.17	1.05	1.07	9.00	24.15	26.43
8.	Karnataka	4.74	4.39	-11.95	5.82	5.13	-5.74	7.52	15.40
9.	Kerala	0.89	0.80	-13.68	2.65	2.72	9.77	48.45	55.32
10.	Madhya Pradesh	9.14	9.45	-1.47	8.25	8.19	6.15	4.46	6.42
11.	Maharashtra	6.74	7.46	5.42	8.15	7.99	4.75	13.26	19.27
12.	Orissa	4.32	3.10	-31.56	4.23	4.28	8.23	8.92	9.78
13.	Punjab	10.61	13.13	17.91	2.19	2.05	0.11	4.78	9.59
14.	Rajasthan	6.46	3.33	-50.87	5.91	6.01	8.70	1.49	16.38
15.	Tamil Nadu	4.33	5.62	23.52	6.09	5.79	1.53	11.35	23.23
16.	Uttar Pradesh	19.00	20.34	2.02	17.09	17.30	8.18	4.75	5.40
17.	West Bengal	6.06	7.79	22.56	7.75	8.22	13.39	31.43	17.84
18.	Other States	0.25	0.04	NA	1.72	2.33	44.27	NA	NA
19.	All India	100	100	4.69	100	100	6.87	12.15	15.21

Venugopal [1992], after evaluating the scheme, found that 'In rural areas, the basic problem faced by the poor, who subsist on daily wages and earnings, is the inability to purchase essential commodities even at prices offered by the PDS. ... (Therefore, he acknowledged that) for the first time in Andhra Pradesh an attempt was made to identify the poor, including those in rural areas, with a view to providing them direct succour by assuring them a certain minimum level of nutrition at affordable prices. ... (He asserted that) the Andhra Pradesh rice scheme highlights the benefits that the poor can derive from a subsidised rural PDS in terms of the security and confidence it generates among the broad masses of the people. It has, according to the beneficiaries, brought them relief and a sense of freedom from dependency and added to their bargaining power. Above all else, it has diminished hunger' [Venugopal, 1992, p. 181, p. 177 and p. 212].

The subsidised rice scheme which originated in

Tamil Nadu has become a powerful political programme in Andhra Pradesh, though it faced premature demise in Tamil Nadu itself. In Karnataka, encouraged by the TDP's Rs 2 per kg rice scheme, Shri Ramakrishna Hegde's government introduced green cards meant only for the poor people. This green card system was an attempt to target the subsidised rice to the poorest of the poor. When it was introduced, the identified number of poor families in Karnataka was about 23 lakh but subsequently the Congress-I government continued this scheme by increasing the number to 52 lakh cards. It should go to the credit of the Janata government headed by Shri Ramakrishna Hegde that they made the PDS to penetrate into the rural areas and removed some of the malpractices which were operating in the PDS. The PDS came to be supervised by the elected Mandal Panchayats which minimised the leakages. But after coming to power, the Congress-I Party government demolished the

Panchayat institutions and, as a result, all the earlier ills of the PDS re-emerged in the rural areas. Meanwhile, the prices of foodgrains started rising much faster than indicated by the wholesale price index or price index for agricultural labourers. The rural as well as the urban poor were feeling the pinch. At this stage, the Janata Dal Party again promised to provide subsidised rice at Rs 3.20 per kg for green card holders. This was nothing but a promise for ensuring basic food to the poorest of the poor.

There is another variant of this subsidised rice scheme which has come to replace the original subsidised rice scheme in Tamil Nadu, i.e., the Mid-Day-Meal scheme. The presently operating Mid-Day-Meal scheme was, no doubt, designed by the then Chief Minister of Tamil Nadu, Shri M.G. Ramachandran, in July 1981-82. But even before this, an attempt was made by the Congress government headed by Kamaraj to provide mid-day meals for the poor children. At that time Shri C. Subramanyam was the Minister of Finance and Education and he introduced the Mid-Day-Meal scheme not as a purely government financed scheme. He persuaded the local people to provide 40 per cent of the cost in the form of cereals, vegetables, fuel, etc., and the government got milk and vegetables, and butter and oil from the Cooperative for American Relief Everywhere (CARE). This Mid-Day-Meal scheme was organised in almost all schools and including some of the schools in urban areas. But this scheme did not encourage the children of poor families to attend the schools regularly. On the contrary, it was found that they dropped out before reaching fifth standard. This scheme was discontinued after sometime, and under the DMK government subsidised rice scheme became prominent. It was only in the 1980s that Mid-Day-Meal scheme was revived and reformulated, when Shri M.G. Ramachandran came to power.

We are all aware that nutritional standard of Indian children and women has been found to be inadequate. This is much more so among the poorer sections. The UNO, under the auspices of the UNESCO, sponsored worldwide nutritional

improvement programme and in India the CARE provided nutritional food for distribution among school going children. But a major portion of the cost of this programme was borne by the American CARE and they distributed mostly milk with bun or bread and such other eatables for school children. It was not considered as a populist programme. But when the Mid-Day-Meal scheme was introduced by Shri M.G. Ramachandran, suddenly the Press pounced on it and branded it as a populist programme. This scheme was not recommended by any nutritional survey or the Planning Commission. It was a scheme entirely started on the personal initiative of the then Chief Minister Shri M.G. Ramachandran. He defended the scheme in the following words: 'This scheme is an outcome of my experience of extreme starvation at an age when I knew only to cry when I was hungry. But for the munificence of women next door who extended a bowl of rice gruel to us and saved us from the cruel hand of death, we would have departed this world long ago. Such merciful womenfolk, having great faith in me, elected me as Chief Minister of Tamil Nadu. To wipe the tears of these women I have taken up this project. To picture lakhs and lakhs of poor children who gather to partake of nutritious meals in the thousands of hamlets and villages all over Tamil Nadu and blessing us in their childish prattle, will be a glorious event' [Harris, 1991, p. 10].

This programme was basically a nutritional programme which provided one-third of the nutritional requirements to the children. It went to improve the health of the future adults and it was a welfare oriented programme since it met the basic needs of the children whose parents were from the families below the poverty line. But it also became a political programme as the scheme was designed in such a way as to attract women of all castes by providing nutritious meals to the non-voting children. Here the beneficiaries are not the voters but they are the children of voters. They include all parents coming from poor families. What is more, this scheme has created a large number of employment opportunities, estimated

to be about 1,80,118 in 1985, for cooking, feeding and cleaning in 68,000 feeding centres. The persons preferred for jobs in these centres are the destitutes and widowed women. Indirectly these employment opportunities act as social security. What is more, it is claimed that children belonging to different castes sit together, eat and mingle. But this is not new as they all meet in the schools which they attend. The claim that it has acted as a remover of social barriers is a bit exaggerated. But what is more substantive is that the school attendance of the children has increased consistently as a result of this Mid-Day-Meal scheme and the UNESCO has acknowledged that this scheme has improved nutritional status of the children.

There are, no doubt, criticisms against this scheme, namely, that it has reduced the teaching hours for the teachers and the data of school children attendance is manipulated. These are all trivial matters when compared to the benefits of the scheme. The Mid-Day-Meal scheme was started during unusually severe drought period and serious inflation year in the rural areas. As a result even the beggars and other destitutes who were facing hunger went and shared the left overs in the feeding centres. This scheme no doubt made Shri M.G. Ramachandran more popular. This created an eyesore for the Congress-I Party and the Congress government at the Centre did not provide substantial financial help. In the beginning it was treated as a non-plan scheme and the Eighth Finance Commission took into account operation costs of Food and Civil Supplies Department and also the cost of subsidy as non-plan expenditure for working out non-plan revenue deficit of the Tamil Nadu government. It was not of much help. Subsequently, the MGR government approached the Planning Commission to treat it as a plan scheme. This request was rejected. But when Shri M G Ramachandran patched up his political differences with Mrs Indira Gandhi and subsequently with Shri Rajiv Gandhi, the Mid-Day-Meal scheme came to be treated as a plan scheme. This is the politics of

poverty indulged in by the Congress-I Party and this behaviour can be explained only in terms of public choice theoretic framework.

In another southern state, i.e., Kerala, a study has shown that a subsidised Public Distribution System has ensured adequate nutrition and almost removed hunger in that state. It has been recognised that the PDS has been operating more effectively in Kerala, thanks to the vigilance of the people. George [1979], who studied the public distribution of foodgrains in Kerala, came to the conclusion that 'subsidised public distribution reduced the skewness in consumption level among the different groups of consumers.... (Further he found that) 'subsidised PDS was better than direct income transfer for raising the consumption levels of low income consumers from the point of view of feasibility and cost effectiveness' [George, 1979]. After examining its overall impact on the producer and consumers in Kerala, he came to the conclusion that 'partial gains to the producers and consumers in Kerala exceeded the direct cost to the government subsidy' [George, 1979, p. 61].

Thus subsidised rice and mid-day-meal schemes though conceived as populist programmes have come to fulfil an important social obligation of democratic government. Their overall impact on the poorer sections has been beneficial.

#### *Loan Waiver Scheme*

After the nationalisation of commercial banks in 1969, the Central government introduced priority lending scheme under which 40 per cent of the bank credit was required to be advanced to the priority sectors which included export, agriculture, small scale industry and weaker sections. This was, no doubt, required as the commercial banks, when they were in private hands, had neglected these sectors. But some political leaders, not satisfied with this targeted credit policy scheme politicised bank lending to such an extent that the banks started feeling that they were no

longer commercial enterprises. No doubt, politicisation of bank loans through loan *melas* brought about a transformation from class banking to mass banking. But it also resulted in developing credit delinquency among poorer sections. Poor people who borrowed loans from commercial banks were even advised not to bother about repaying them. We are all aware of the disastrous consequences of such politicisation on the commercial banks and the credit worthiness of the poor people in the country. Khusro Committee passed strong strictures on such politicisation of bank loans and observed that 'while mandatory and concessionary programmes and interest rates are valid, we are clear that these should not be administered with populist motives. In fact, we believe that time has come for political, social and institutional leadership, including the leadership of the credit systems to signal and to tell the people and the recipients of credit, etc., that the future lies not in demanding a further benefit, a further subsidy, a further reduction in concessionary lending rates and further write-off of interest and loan amounts, that is, to say yet another set of crutches but in productive endeavour, discipline and risk-taking, leading to self-reliance, higher incomes and better life' [Khusro, 1989, p. 6]. The Narasimham Committee even went to the extent of advising the government to scale down the priority lending sharply to 10 per cent [Narasimham, 1991, p. vi].

But what really distorted the whole credit system in the rural areas was the loan waiver scheme, in addition to politicisation of loan *melas*. Most of the loans provided to the agriculturists came from commercial banks and cooperative institutions. These loans should be necessarily sanctioned on the basis of proper assessment of the purpose for which the loans are required, the credit record of the borrowers and the possibility of productive utilisation of those loans. The farmers borrow loans and, in their usual way, some of them use it for productive purpose and some of them do not.

First, populism was confined to the writing-off of interest on loans, and subsequently, it was extended to the writing-off of the principal amount itself. In 1979, the Congress-I government in Maharashtra waived interest on cooperative loans for small farmers which amounted to about Rs 49 crore. This was intended to woo the poor farmers and muster their votes for the Congress-I Party. The Government of India, (Janata Dal government) imitated this scheme in 1980 and waived interest on crop loans given in 1977 to the small farmers for the Kharif crop. The Government of India issued a notification that this was meant for providing relief to those affected by drought. No estimation of the amount involved was made. In Karnataka, the Janata government after coming to power in 1983 waived the interest on cooperative loans which were overdue till June 1982. This interest waiver scheme was made applicable to all farmers. The number of farmers likely to benefit was 15.5 lakh and the amount involved was Rs 48.5 crore. The Congress-I government also continued this kind of loan waiver and the present Janata Dal government has got into trouble with the NABARD by waiving penal as well as normal interest on cooperative loans amounting to Rs 130 crore.

Not satisfied with waiving the interest amount, some of the state governments started waiving the loan amount itself. This is a very bold measure. It amounts to asking people to borrow first with the hope that later their loans will be converted into outright grants. Maharashtra government was the greatest culprit in this game of political populism. In 1980, all cooperative loans outstanding till June 1979 from small farmers numbering about 8 lakh were waived. The amount involved was Rs 49 crore. In Tamil Nadu, all farm loans of all farmers amounting to Rs 58 crore were waived in 1980. This populist scheme spread like wild fire. The government of Madhya Pradesh waived cooperative loans of the farmers who owned less than 10 acres of land in 1984. The number of farmers estimated to have benefited from this loan waiver scheme was 1.65 lakh and the amount of loan involved was Rs 10.5 crore.

The disease soon spread to Northern India. The Haryana government headed by Choudhuri Devilal waived all farm loans up to Rs 20,000 in 1987. The amount involved was Rs 389 crore. Since loan waiver became a regular economic programme of many state governments, the Congress-I government in Maharashtra again waived agricultural loans given by the state government to all farmers in 1988. The amount involved was Rs 220 crore (Table 5).

TABLE 5. SOME INSTANCES OF FARM LOAN/INTEREST WAIVERS

State/Government	Year	Type of Loan	Intended Beneficiaries	Stated Objective	Total Amount (Rs)
(1)	(2)	(3)	(4)	(5)	(6)
<i>Loan Waivers</i>					
1. Maharashtra	1980	All co-op loans outstanding till June 1979	Small beneficiaries (8 lakh)	-	49 crore
2. Tamil Nadu	1980	All farm loans	All farmers	To mitigate the plight of farmers	58 crore
3. Madhya Pradesh	1984	All co-op loans	Farmers with <10 acres (1.65 lakh)	-	10.5 crore
4. Haryana	1987	All farm loans	Borrowers with loan up to Rs 20,000	Uplift the weaker farmers and reinvigorate the rural economy	389 crore
5. Maharashtra	1988	Agricultural loans given by state government	All farmers	Free the farmers from debt burden	220 crore
<i>Interest Waivers</i>					
1. Maharashtra	1979	Co-op loans	Small farmers	-	49 crore
2. Govt. of India	1980	Crop loans given for 1977 kharif	Small farmers	Relief to those affected by drought	-
3. Karnataka	1983	Co-op loans overdue till June 1982	All farmers (15.5 lakh)	Relief to farmers and improve loan recovery	48.5 crore
4. Karnataka	1995	Co-op loans overdue till May 1995	All farmers	Only interest on loans	130 crore

Sources: 1. R.C. Dwivedi *Glimpses of Cooperatives Through Press*, Vol. 8, Agricultural Credit Cooperatives, The Cooperative Times, New Delhi, 1990, Pp. 158-9.

2. *The Economic Times* dated 25.1.1980, 3.7.1980, 4.7.1980, 22.6.1987 and 3.11.1988.

3. Government of Karnataka, *Impact of Interest Subsidy Scheme*, Institutional Finance and Statistics Department, Bangalore, 1986, Pp. 39-44.

TABLE 6. MAGNITUDE OF INSTITUTIONAL RURAL CREDIT OUTSTANDING IN 1989 AND THE BORROWERS COVERED UNDER THE AGRICULTURAL AND RURAL DEBT RELIEF SCHEME (ARDRS)

Institutions	Total Agricultural and Rural Credit Outstanding (June 1989)		Eligible Borrowers Under ARDRS			
			Outstanding		Overdues	
	No. of Borrowers (lakh)	Amount (Rs crore)	No. of Borrowers (lakh)	Amount (Rs crore)	No. of Borrowers (lakh)	Amount (Rs crore)
(1)	(2)	(3)	(4)	(5)	(6)	(7)
PACSS <sup>1</sup>	318	6,363	318	6,363	167	3,323
LDBs	na	2,693	na	2,693	na	686
CBs	203	13,923	185	11,957	na	2,503 <sup>2</sup>
RRBs	99	2,630	64	1,709	30	623 <sup>3</sup>
Total	620	25,609	567	22,722	-	7,135

Notes: na = not available.

1. including FSSs and LAMPs.

2. includes overdues of only agricultural and allied activities.

3. the overdue figures of RRBs are at the end of the March 1989.

CBs Commercial Banks.

FSSs Farmers' Service Societies.

LAMPs Large Sized Multipurpose Societies.

LDBs Land Development Banks.

PACSS Primary Agricultural Credit Societies.

RRBs Regional Rural Banks.

Sources: 1. Reserve Bank of India, *Banking Statistics*, Basic Statistical Returns, Vol. 18, June 1989, Bombay, 1991.2. National Bank for Agriculture and Rural Development, *Statistical Statements Relating to the Co-operative Movement in India 1988-89*, Part 1, Credit Societies, Bombay, 1992.

TABLE 7. INSTITUTION-WISE NUMBER OF BENEFICIARIES COVERED AND AMOUNT OF DEBT RELIEF PROVIDED UNDER ARDRS

Institution	No. of Beneficiaries (lakh)	Debt Relief (Rs crore)	Average Debt Relief (Rs)
(1)	(2)	(3)	(4)
PACSS	162.20 (50.7)	3,351.38 (42.8)	2,066
LDBs	23.54 (7.4)	844.41 (10.8)	3,587
CBs	97.66 (30.5)	2,834.49 (36.2)	2,902
RRBs	36.48 (11.4)	795.13 (10.2)	2,179
Total	319.89(100.0)	7,825.41(100.0)	2,446

Note: Figures in brackets are percentages to total.

Sources: 1. National Bank for Agriculture and Rural Development-Production Credit Department, Bombay.

2. Reserve Bank of India - Rural Planning and Credit Department, Bombay.

This competitive populism which was confined to only the state governments spread to the central government as well. The Union Budget for 1990-91 presented by Madhu Dandavate, who was the Union Finance Minister in the National Front Government, announced debt relief to farmers, artisans and weavers who had taken loans up to Rs 10,000 from public sector banks and Regional Rural Banks, irrespective of the size of their land holdings. Subsequently, the scheme

was extended to cover cottage and village industries, handicrafts and other rural crafts. The loan waiver was confined originally to the loans made by the public sector banks. But, subsequently, it was extended to cooperative loans also by asking the state governments to share 50 per cent of the financial burden. This scheme which was known as the Agricultural and Rural Debt Relief Scheme (ARDRS) was the outcome of an election promise made by the political parties,

which constituted the National Front Government, in their 1989 Parliamentary election manifesto. The total amount of loans written off by commercial banks, Regional Rural Banks (RRBs), Central Cooperative Banks CCBs, Primary Agricultural Credit Societies (PACSs), including Farmers Service Society, multipurpose societies, Central Land Development Banks, Primary Land Development Banks, Primary Cooperative and Industrial Societies and Weaver Societies amounted to Rs 7,825.41 crore. It covered about 32 crore borrowers from all over the country. No doubt, the scheme prescribed certain eligibility criteria, like short-term loans including converted/rescheduled medium term loans availed by individual borrowers on or before October 2, 1989, overdue loan of a borrower who was declared as insolvent and whose insolvency petition was pending before the court on or before 2nd October 1989 and loan which was converted into medium term loan on account of bad crop. On an average a beneficiary borrower received a debt relief of Rs 2,446. The scheme covered 48 per cent of total rural borrowers and about 31 per cent of the rural credit in 1989. Among the institutions which bore the brunt of burden, PACSs shared 51 per cent of the borrowers and 43 per cent of the outstanding loans and commercial banks 30.5 per cent of the borrowers and 36.2 per cent of the loans. The major share of the beneficiaries covered and the relief given was under the cooperative sector benefitting 1.86 crore of borrowers writing-off Rs 4,195.8 crore of loan amount (Table 7).

Arguments advanced by the central and state governments to defend this scheme were that it was intended to give debt relief to the farmers on the lines comparable to the debt relief to the industrialists. In fact one of the arguments advanced was that the amount involved in such a scheme is nothing when compared to huge loan-write-offs done by the banking system regularly in the case of industrial sector. Almost all state governments which resorted to this loan waiver populist scheme justified it on the ground that it was intended to mitigate the plight of farmers, uplift the weaker farmers, reinvigorate farmers and free them from debt burden, providing relief to those affected by drought and,

what is interesting, to improve loan recovery.

Several evaluation studies have shown the harmful effects of these loan waiver schemes. In their recent study, Shylendra and Khatar Singh have clearly found that the credit institutions both in dry and irrigated areas have faced a drastic fall in their annual disbursement and recovery of agricultural loans [Shylendra and Khatar Singh, November 1994]. The Agriculture Credit Institutions including NABARD faced a setback in their performance operations from 1989 onwards. The study has found that the loan waiver scheme is bound to hamper the functioning of the credit institutions leading to a slow down of a flow of funds to agriculture from the institutional credit agencies. The loan recovery atmosphere has got vitiated by frequent politically motivated interventions.

We are all aware of the loss of credit worthiness of farmers in recent years. The banks are reluctant to lend to agriculture even under liberalisation programme. They window-dress their accounts to show that they have lent enough, and the farmers are not in a position to get funds from any organised institutional channel. Consequently, they are driven back to the village money lender. All the efforts of the earlier governments starting from implementation of the All India Rural Credit Survey Committee of 1954 to the nationalisation of commercial banks in 1969 have now been wasted. The farmer is back to square one and this is the consequence of the populist programme of loan waiver. I hope that the political leaders will realise the damage which they have done to the rural people in an attempt to garner their votes for their political parties.

It is true that during the later part of the nineteenth and early part of the twentieth centuries the British provincial governments used to provide debt relief to the farmers by cancellation of debt owed by the farmers to the money lenders. This was done in the context of exploitative credit system operated by village money lenders who indulged in usury and falsification of contract records. The Government of India and the Reserve Bank of India struggled hard to replace money lenders and establish organised credit system in rural areas. They encouraged and promoted cooperative credit institutions. After 1969,



commercial banks were made to set apart a part of their credit for rural areas. But politicians have ruined all these institutions through politicisation and populist schemes.

### *Concluding Remarks*

In the foregoing pages we have shown that populist programmes were launched as redistributive strategies. The paper also highlights the fact that one of these programmes did serve the intended redistributive purpose whereas another has resulted in disaster. It is the duty of economists to inform the political leaders to exercise caution in formulating redistributive programmes. While we all accept their right to formulate and implement redistributive programmes, we have a duty to tell them not to resort to cheap populism without examining the financial and administrative feasibility of the schemes. For example, how can any sensible person promise to bring down prices within 100 days? Is it possible? How can any one in authority remove absolute poverty of the people of Bihar in five years, if it was not possible to do it in the last 45 years? Where is the money and administrative capacity to give *Roti, Kapada*, and *Makan* to all poor people in Bihar? How can Bharatiya Janata Party (BJP) arrange to prepare and supply *Jhunka* and *Bhakar* to poor people, even if they are able to mobilise funds to supply, at Re 1? Is it administratively possible? Undoubtedly, these are going to be false promises. What is more, even if some of the populist programmes are redistributive strategies in their content, economists should point out that some of them may harm the very interests of the people for whom they are intended. This has been proved

by the loan waiver scheme. Thus, though the right kind of redistributive populist programmes have a place in democracy where inequalities of income and wealth are wide and persisting, the political parties and governments should not continue to rely on them to solve the basic problem of poverty. They should be treated as only temporary and supplementary measures and not long term solutions to solve the social and economic problems of a country like India.

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## PANCHAYATS IN INDIA - APPROACHES AND GROUND REALITIES IN A HISTORICAL PERSPECTIVE

F. K. Wadia

*The panchayats have had a chequered history in the country. After fits and starts of establishing them during the British Period, they were set up in most parts of the country after Independence. The Panchayati Raj Institutions were on their ascendancy during 1959-64, stagnated during 1965-69 and entered a phase of decline thereafter. The 73rd Constitution Amendment Bill passed in 1993 visualises the grant of powers and ensuring elections being held regularly. The Bill also gives authority to panchayats to undertake development programmes, provisions for grant-in-aid from the Consolidated Fund of India for the purpose, and setting up of State Finance Commissions every five years for providing funds to the panchayats.*

### *Introduction*

The institution of village councils or panchayats has prevailed in the country since ancient times. These bodies were known by different names, such as the *panchmandalis* in Central India, *gramajanapadas* in Bihar during the Gupta period (300-550 AD), and *panchakulas* in Rajputana. The panchayat administered the affairs of a village on its own responsibility or as an advisory body to the village headman. It administered justice, maintained local order by watch and ward staff, provided for education and sanitation, construction of buildings, roads, tanks and wells, etc. With the advent of the British rule in India, and centralised administration, the institution went into decay in most parts of the country.

### *Lord Mayo's Resolution, 1870*

A scheme of decentralisation was first initiated in 1870 by the then Viceroy of India, Lord Mayo, principally to allocate financial powers and responsibilities to the Provincial Governments. In his Resolution dated December 14, 1870, it was mentioned 'that the Supreme and Local Governments regard from different points of view, measures involving expenditure; and the division of responsibility being ill-defined, there occur conflicts of opinion injurious to the public service. In order to avoid these conflicts, it is expedient that, as far as possible the obligation to find the funds necessary for administrative improvements should rest upon the authority whose immediate duty it is to devise such measures'. The Resolution further went on to say that

'local interest, supervision, and care are necessary to success in the management of funds devoted to Education, Sanitation, Medical Charity and Local Public Works. The operation of this Resolution in its full meaning and integrity will afford opportunities for the development of self-government, for strengthening municipal institutions, and for the association of Natives and Europeans to a great extent than heretofore in the administration of affairs' [Hunter, 1875, Vol. II, Pp. 57-60].

### *Lord Ripon's Resolution, 1882*

Based on this latter part of the Resolution, a later Viceroy, Lord Ripon, elaborated the principle of decentralisation further in his Resolution of May 18, 1882. The Resolution stated 'that the time has now arrived when further practical development may be afforded to Lord Mayo's Government, and that the Provincial Governments should no longer exclude from all consideration the mass of taxation under Local and Municipal management, together with similar resources still retained in Provincial control, and ignore the question of local self-government. The Provincial Governments, while being now largely endowed from Imperial sources, may well, in their turn, hand over to local self-government considerable revenues, at present kept in their hands, but similar in kind to many which have long been 'locally' managed with success by committees, partly composed of non-official members, and subject only to general remedial control reserved to the State by the Legislature. At the same time, such items should be generally made local as the people are most likely to be able to understand the use of

and to understand them well. His Excellency would therefore invite the Local Governments to undertake a careful scrutiny of Provincial, Local and Municipal accounts, with the view of ascertaining (1) what items of receipt and charge can be transferred from 'Provincial' to 'Local' heads for administration by Committees comprising non-official and, wherever possible, elected members, and what items already 'Local' but not so administered, might suitably be so; (2) what redistribution of items is desirable, in order to lay on Local and Municipal bodies those which are best understood and appreciated by the people; (3) what measures, legislative or otherwise, are necessary to ensure more local self-government. Incidental to the scrutiny they will probably notice, and might carefully consider (4) ways of equalising local and municipal taxation throughout the Empire, checking severe or unsuitable imports, and favouring forms most in accordance with popular opinion or sentiment....'

The 'general mode' given to the principle of local self-government was elaborated in the Resolution as follows. 'At the outset, the Governor-General in Council must explain that, in advocating the extension of local self-government, and the adoption of this principle in the management of many branches of local affairs, he does not suppose that the work will be in the first instance better done than if it remained in the sole hands of the Government district officers. It is not, primarily, with a view to improvement in administration that this measure is put forward and supported. It is chiefly desirable as an instrument of political and popular education. ... in course of time, as local knowledge and local interest are brought to bear more freely upon local administration, improved efficiency will in fact follow'.

... 'The task of administration is yearly becoming more onerous as the country progresses in civilisation and material prosperity.... The universal complaint in all departments is that of overwork. Under these circumstances it becomes imperatively necessary to look around for some means of relief; ... the only reasonable plan open to the Government is to induce the people themselves to undertake, as far as may be, the management of their own affairs; and to develop, or

create if need be, a capacity for self-help in respect of all matters that have not, for imperial reasons, to be retained in the hands of the representatives of Government'.

... 'The general principles upon which, ... these measures should be shaped ... may be divided into two parts - the first, relating to the mode in which local boards, whether municipal or district, should generally be constituted; and the second, to the degrees of control which the Government should retain over such bodies, and the manner in which that control should be exercised. ... while maintaining and extending, as far as practicable, the plan of municipal government in the cities and towns of each province, the Local Governments will also maintain and extend throughout the country, in every district where intelligent non-official agency can be found, a net-work of local boards, to be charged with definite duties and entrusted with definite funds. ... the area of jurisdiction allotted to each board should in no case be too large. If the plan is to succeed at all, it will be necessary to secure among the members both local interest and local knowledge .... The smallest administrative unit - the sub-division, the taluka or the tahsil - shall ordinarily form the maximum area to be placed under a local board ... even smaller jurisdictions could be deemed suitable'.

The Resolution further stated that 'not only should every local board have the entire control over the proceeds of all local rates and cesses levied within its jurisdiction for its own special purposes, but along with the charge of any expenditure that is at present Provincial should be transferred, where possible, the management of equivalent revenue' [Palit, 1882, Pt II, Pp. 36-51].

#### *Royal Commission On Decentralisation, 1909*

In September 1907, the Royal Commission upon Decentralisation in India was set up 'to enquire into the relations ... existing for financial and administrative purposes between the Supreme Government and the various Provincial Governments in India, and between the Provincial Governments and the authorities subordinate to them, and to report whether, by measures of decentralisation or otherwise, these relations can

be simplified and improved, and the system of Government better adapted both to meet the requirements and promote the welfare of the different Provinces, and, without impairing its strength and unity, to bring the executive power into closer touch with local conditions' [Hobhouse, 1909, Vol. I, p. 111]. The Commission submitted its Report in February 1909.

Part III of the Commission's Report dealt with village organisations and local self-government. The Commission mentioned that 'throughout the greater part of India the village constitutes the primary territorial unit of Government organisation, and from the villages are built up the larger administrative entities - tahsils, sub-divisions, and districts.... The Indian villages formerly possessed a large degree of local autonomy, since the native dynasties and their local representatives did not, as a rule, concern themselves with the individual cultivators, but regarded the village as a whole, or some large landholder, as responsible for the payment of the Government revenues, and the maintenance of local order. This autonomy has now disappeared, owing to the establishment of local civil and criminal courts, the present revenue and police organisation, the increase of communication, the growth of individualism, and the operation of the individual raiyatwari system which is extending even in the north of India. Nevertheless, the village remains the first unit of administration; the principal village functionaries - the headman, the accountant, and the village watchman - are largely utilised and paid by Government, and there is still a certain amount of common village feeling and interests' [Hobhouse, 1909, Pp. 236-237].

The Commission went on further to say that 'we do not think it possible, even if it were expedient, to restore the ancient village system, under which the community was responsible for each of its members, and in turn claimed the right to regulate his actions: but we hold that it is most desirable, alike in the interests of decentralisation and in order to associate the people with the local tasks of administration, that an attempt should be made to constitute and develop village panchayats for the administration of local village affairs'.

'We are of opinion also that the foundation of any stable edifice which shall associate the people

with the administration must be the village, as being an area of much greater antiquity than administrative creations such as tahsils, and one in which the people are known to one another, and have interests which converge on definite and well-recognised objects like water supply and drainage. It is probable indeed, that the scant success of the efforts hitherto made to introduce a system of rural self-government is largely due to the fact that we have not built up from the bottom .... The fact is that the character of village varies materially, not merely in the different Provinces, but in different areas within the same Province, and even within the individual districts and tahsils. They are in different stages of adequate organisation for common action, and even where the material for such organisation exists, public spirit may be poisoned by caste and faction disputes'.

'While therefore, we desire the development of a panchayat system, and consider the objections urged thereto are far from insurmountable, we recognise that such a system can only be gradually and tentatively applied, and that it is impossible to suggest any uniform and definite method of procedure. We think that a commencement should be made by giving certain limited powers to panchayats in those villages in which circumstances are most favourable by reason of homogeneity, natural intelligence, and freedom from internal feuds. These powers might be increased gradually as results warrant, and with success here, it will become easier to apply the system in other villages'.

'Such a policy, which must be the work of many years, will require great care and discretion, much patience and judicious discrimination between the circumstances of different villages; and there is a considerable consensus of opinion that this new departure should be made under the special guidance of sympathetic officers' [Hobhouse, 1909, Pp. 239-40].

The Commission summarised its recommendations for the village organisation as follows: (a) 'It is most desirable to constitute and develop village panchayats for the administration of certain local affairs within the villages. This system must, however, be gradually and cautiously worked. The headman of the village,

where one is recognised, should be ex-officio chairman of the panchayat; other members should be obtained by a system of informal election by the villagers. The panchayat should be a small body of about five members, and only in exceptional circumstances should different villages be brought under the same panchayat. (b) The functions of panchayats must be largely determined by local circumstances and experience. We make the following general suggestions: (i) They should have summary jurisdiction in petty civil and criminal cases. (ii) They should be allowed to incur expenditure on the cleansing of the village and minor village works. (iii) They might be entrusted with the construction and maintenance of village school-houses, and with some local control in respect of school management. (iv) Selected panchayats might have the management of small fuel and fodder reserves. (c) We consider it essential for the success of the panchayat system that it should not be concomitant with any new form of local taxation. Panchayats should receive a portion of the land cess levied for local board purposes in the village, special grants for particular objects of local importance, receipts from village cattle-pounds and markets entrusted to their management, and small fees on civil suits filed before them. Their application of the funds entrusted to them should be judged by general results, and should not be subject to rigid audit. (d) With the panchayat system thus developed, we do not consider it necessary to retain artificial local agencies such as village unions and sanitary committees. (e) Such outside supervision of panchayat affairs as is necessary, including the creation of new panchayats, enhancement or diminution of powers, and, where necessary, abolition of an unsatisfactory panchayat, must rest with the district officers, panchayats should not be placed under the control of district or sub-district boards; and (f) we call attention to evidence received in some Provinces as to the under-payment of village officers, and their resort to corrupt practices' [Hobhouse, 1909, p. 306].

The Commission discussed the various types of rural boards - district and sub-district - set up on the basis of Lord Ripon's Resolution and opined 'that sub-district board should form an essential part of the scheme of local self-government, that

they should have adequate resources and a large measure of independence, and that their jurisdiction should be limited in area as to ensure both local knowledge and interest on the part of the members, and be at the same time a unit well known to the people. ... we consider that as local self-government should commence in the villages with the establishment of village panchayats, so the next step should be the constitution of boards for areas of smaller size than a district. We desire, therefore, to see sub-district boards universally established, as the principal agencies of rural board administration. We think that the taluk or tahsil will ordinarily be the best jurisdictional unit for sub-district boards' [Hobhouse, 1909, Pp. 248-49].

#### *Government of India Resolution, 1915*

With the general line of the (Decentralisation) Commission's proposal, the Government of India in their Resolution of 1915 expressed their concurrence, and in leaving the matter in the hands of local governments they suggested the following general principles as indicating the lines on which advance was most likely to be successful: (i) The experiments should be made in selected villages or areas larger than a village, where the people in general agree. (ii) Legislation, where necessary, should be permissive and general. The powers and duties of panchayats, whether administrative or judicial, need not and, indeed, should not, be identical in every village. (iii) In areas where it is considered desirable to confer judicial as well as administrative functions upon panchayats, the same body should exercise both functions. (iv) Existing village administrative Committees, such as village sanitation and education committees, should be merged in the village panchayats where these are established. (v) The jurisdiction of panchayats in judicial cases should ordinarily be permissive, but in order to provide inducement to litigants, reasonable facilities might be allowed to persons wishing to have their cases decided by panchayats. For instance, court fees, if levied, should be small, technicalities in procedure should be avoided and possibly a speedier execution of decrees permitted. (vi) Powers of permissive taxation may be conferred

on panchayats where desired, subject to the control of the local government but the development of the panchayat system should not be prejudiced by an excessive association with taxation. (vii) The relations of panchayats on the administrative side with other administrative bodies should be clearly defined. If they are financed by District or Sub-district Boards there can be no objection to small supervision by such Boards [Venkatarangaiya and Pattabhiram, 1969, Pp. 188-89].

#### *Montagu-Chelmsford Reforms, 1918*

The Indian Constitutional Reforms (Montagu-Chelmsford) Report, 1918 were next to refer to the panchayat system. It was recognised that the prospect of successfully developing panchayats must depend very largely on local conditions, and that the functions and powers to be allotted to them must vary accordingly; but where the system proved a success, it was contemplated that they might be endowed with civil and criminal jurisdiction in petty cases, some administrative powers as regards sanitation and education, and permissive powers of imposing a local rate wherever possible. As the scheme of local self-government was still under consideration it could not be regarded as constituting a complete scheme for two reasons: 'It is impossible to ignore the past and at once to create a perfect scheme out of the present uneven materials; and secondly, if we are sincere in our advocacy of a policy of provincial autonomy, we must leave the work mainly to local Governments. It would be highly inconsistent to insist on provincial autonomy, and simultaneously to leave no latitude of action to provincial Governments in a field which is so peculiarly a matter for local development' [Montagu-Chelmsford, 1918, Pp. 127-128].

#### *Government of India Resolution, 1918*

(a) *Modifications Suggested to the 1915 Resolution:* The Government of India Resolution of 1918 was a corollary to the Montagu-Chelmsford Report on Indian Constitutional Reforms. The Resolution recommended the widening of the base of village panchayats, so that they might

become the natural expression of the corporate life of individual villages. The 1918 Resolution, while referring to the 1915 Resolution, suggested the following modifications with regard to the panchayat system: 'The development of the panchayat system has since attracted considerable attention in several provinces and legislation has been introduced in Assam for the purpose of instituting a system of this kind, while a special committee has investigated and reported on the subject in the United Provinces. The Government of India desire that the matter should be further pursued and with the exceptions noted below they concur in the views expressed in the Resolution of 1915. They would, however, modify the first of the principles suggested in that Resolution by saying that the area under a panchayat should normally be a village unless, as above stated, villages are so closely connected that they may be treated as one. The Government of India would further omit the seventh of the principles quoted (under the 1915 Resolution) on the ground that at the present stage it is not desirable to make any rigid classification of the connection of panchayats with other administrative bodies from which indeed they should be kept apart as much as possible, while the way in which they do their work should be tested by inspections by the administrative district staff. At the outset, moreover, such control as is necessary in the way of replacing incompetent panchayats should be exercised by the local revenue officers provided that these be of a grade higher than that of Tehsildar'.

'As regards the constitution of the panchayats, the points to which the Government of India attach more importance are the association of the principal village officers with the panchayats and an informal election of the other members by the villagers themselves. They would, however, allow the panchayat to choose its own president and would not render it obligatory that the president should be the village headman as suggested by the Decentralisation Commission. Of the possible functions to be assigned to panchayats the most important are, in their opinion, village sanitation and village education ... and jurisdiction in petty civil and criminal cases. With reference to this last class of functions, it is especially

desirable that the panchayat should be, as a rule, a body representing a single village, otherwise the great safeguard for the proper disposal of such cases, namely, local public opinion will be lost. It should also be permissible, though not as the Commission suggested universally necessary, that the panchayat should receive some portion of the land cess raised in their villages. The Government of India are also prepared, differing herein from the opinion of the Decentralisation Commission, to allow to the panchayats voluntary powers of supplementary taxation, the proceeds of which would be devoted to the special purpose or purposes for which the tax was levied.

*(b) Exceptions and Alternatives:* 'Where it is decided to call these panchayats into existence the legislation entailed should be as simple and elastic as possible with the fullest scope for details. These may be left to rules which will be gradually evolved and be improved by experience. The Government of India, however, recognise the impossibility of any universal enforcement of a system of panchayats by reason of the different circumstances prevailing in different tracts, in some of which indeed there are no regular villages at all. It is essential, however, that an effective beginning should be made, where possible; and, if the government of any province, where there is still some real village life, should think that these recommendations are unsuited to local circumstances, it will be open to such a government to put forward alternative proposals. It is not, for instance, intended to prevent in any way the establishment of unions or circles for local self-government purposes.... Such unions or circles may be a very useful adjunct to District and Sub-district Boards relieving them of duties which can be better discharged by committees dealing with smaller areas and such bodies would be especially useful and desirable in tracts in which it is found impossible or premature to establish a Village Panchayat system'.

*(c) Action Now Required:* 'It will probably be found on examination that a large part of the suggestions put forward in this Resolution can be brought into effect without any change in the existing legislation and so far as this can be done,

action should be taken without further delay. In some provinces, as in Madras, the amendment of the existing law is already in contemplation. In others, as in the United Provinces and Assam, there has been recent legislation which to a large extent meets the necessities of the present Resolution and it will be for the local governments in such provinces to determine whether fresh legislation will be necessary at the present time to meet the requirements now suggested. The development of a Village Panchayat system, where this is undertaken, should in any case be secured by separate legislation unconnected with the Acts relating to municipal and rural Boards'.

'It is hoped that by the adoption of the policy indicated in this Resolution, a substantial advance may be made in the direction of a more developed and more liberal form of local self-government. It is probably in the sphere of local self-government more than in any other that the changes which are now being effected in India will touch the great mass of the population. If the local administration is freed in the manner proposed from undue official guidance, a vast number of persons should feel themselves for the first time placed in effective control of the matters which affect their everyday life and the local bodies will be invested with opportunities not hitherto enjoyed by them of improving the conditions of the populations entrusted to their charge. The duties of local bodies cover most of the activities upon which the essential welfare of the country depends. They have the care of the public health and the circumstances upon which that health depends: they control elementary education: they construct and maintain local buildings and communications and they touch the life and convenience of the people at every point. In the development of their interests and the extension of their responsibilities the self-government of the country will secure a very real and important advance and it is on the increased experience to be gained in the administration of local civic affairs that the country must to a large degree rely for the expansion of its self-dependence in the sphere of central government' [Venkatarangaiya and Pattabhiram, 1969, Pp. 189-192].

A number of Provinces passed Panchayat Acts,

particularly after 1919. Thus Bengal passed the Bengal Village Self-Government Act, 1919 and Bombay passed the Bombay Village Panchayats Act, 1920 (repealed and supplemented by the Act of 1933). Other enactments included the Central Provinces Village Panchayats Act, 1920, the Madras Village Panchayat Act, 1920 (replaced and supplemented by the Madras Local Boards Act, 1930), the United Provinces Village Panchayats Act, 1920, the Punjab Village Panchayats Act, 1921, the Bihar and Orissa Village Administration Act, 1922 and the Assam Rural Self-Government Act, 1926. Certain Indian States, notably Baroda, Travancore, Mysore and Indore also passed legislation for setting up village panchayats [Ministry of Food and Agriculture, 1954, p. (ii)].

*Report of the Indian Statutory (Simon) Commission, 1930*

In 1930, the Indian Statutory Commission referred to the position of village panchayats in the country in Volume I of its Report. It mentioned that 'The Village Panchayat, or Union Board, is of special interest and importance as being an attempt to recreate the village as a unit of self-government. Its primary function is to look after such matters as wells and sanitation, but it is sometimes entrusted with the care of minor roads and the management of schools and dispensaries and, in Madras, of village forests and irrigation works. In some provinces it has also been given power to deal with petty criminal and civil cases. It is interesting to note that a panchayat which exercises all these functions is, within its total range, dealing with both reserved and transferred subjects. Except in the United Provinces, the members are almost entirely elected. In Madras, Bombay and Assam all male adults, and in the Central Provinces all adults, have the vote. Voting is often by show of hands'.

'In spite of great efforts to establish these village authorities, it has not proved possible to progress very rapidly. Development is promising and has gone furthest in the United Provinces, Bengal and Madras. In Bengal, by 1928, 2,874 Union Boards had been established out of a possible 6,478. In the United Provinces in 1927, there were 4,594

panchayats with jurisdiction over a population of nearly 8.5 millions. Outside these three provinces, the movement is still completely in its infancy. To take a typical instance, in Bombay in 1925-26, the population affected by the village panchayats was only a little over half a million. It is very far from certain that it will eventually be possible to create satisfactory bodies of this type over all the areas of the provinces .... A common obstacle is the refusal of a village to have anything to do with the constituting of a fresh tax authority'.

The Commission quoted from the United Provinces Government Memorandum of the kind of difficulties met in the formation of panchayats as follows: 'The selection of villages in which panchayats can be established with a hope of success demands caution. The field of choice is restricted. In the first place, villages which are riven by faction must be avoided. Elsewhere men of the necessary intelligence, integrity and force of character are often absent, or if present, belong to a single caste or family, with the result that a well balanced panchayat cannot be formed. Many villages are entirely apathetic. Again, experience has shown that panchayats rarely flourish when over-shadowed by the influence of a powerful land-holder to whom the tenants have been in the habit of taking their disputes. Lastly, considerable difficulty has been experienced in the selection of suitable *sarpanches* (presidents) on whose personality the success of the panchayat almost entirely depends. In remote tracts it has not been easy to discover men of the right type for these posts who had also sufficient education and intelligence to understand the simple rules and maintain the simple registers. The increasing influence of village factions and caste and communal friction has affected the working of panchayats in some places' [Indian Statutory Commission, 1930, Vol I, Pp. 306-307].

The Government of India Act, 1935, included the subject of Local-Self Government in the Provincial Legislative List. In 1937, with the assumption of popular ministries, the provincial Governments of United Provinces and Bombay appointed Committees to recommend the lines on which local self-government should be reorganised. In the Central Provinces, a plan for reconstruction of local self-government was



drawn up in 1938. However, with the advent of the Second World War, the provincial ministers resigned in eight States. It was only after Independence that the setting up of panchayats was again considered.

### *Independence and After*

Article 40 of the Constitution of India, under the Directive Principles of State Policy provided that 'the State shall take steps to organise village panchayats and endow them with such powers and authority as may be necessary to enable them to function as units of self-government' [Ministry of Law and Justice, 1989, p. 21]. Further, under List II of the Seventh Schedule of the Constitution, that is the State List, 'Local government, that is to say, the constitution and powers of municipal corporations, improvement trusts, district boards, mining settlement authorities and other local authorities for the purpose of local self-government or village administration' was to remain the domain of the State Governments [Ministry of Law and Justice, 1989, p. 284-285].

Measures were therefore taken by the State Governments to improve upon the existing legislation or enact new laws with a view to promoting quicker development of panchayats as well as entrusting them with greater responsibilities. By 1951-52, there were over 70,000 panchayats functioning in the country, entrusted with a wide field of activities. These panchayats were largely elective bodies, the members being elected by the adult residents of the panchayat area. The panchayat area varied from a single village to a group of villages, depending upon the size of the population in the villages; the distance between villages and the terrain. The statutory functions delegated to the panchayats under the Acts included administrative, civic, social, economic, statistics and intelligence, judicial and police. In order to provide the requisite finance for implementing the functions delegated to the panchayats, the laws provided for a number of sources of finance. These included taxes, cesses, fees, fines, grants, contributions, loans, etc. The major sources of finance were grants from State Governments and a share of the land revenue collections. The Acts

also gave powers to panchayats to introduce compulsory manual labour for purposes of public utility and option to individuals to render physical labour in lieu of cash taxes [Ministry of Food and Agriculture, 1954, Pp. iv-v].

The First Five Year Plan laid great stress on the strengthening of village panchayats and their active association in the process of development of the village concerned. 'Unless a village agency can assume responsibility and initiative for developing the resources of the village, it will be difficult to make a marked impression on rural life, for, only a village organisation, representing the community as a whole can provide the necessary leadership. As the agencies of the State Government cannot easily approach each individual villager separately, progress depends largely on the existence of an active organisation in the village which can bring the people into common programmes to be carried out with the assistance of the administration. While co-operatives functioned to the limited interest of its members, the panchayats represent the entire village community including those who are landless or are not engaged in cultivation, and has to meet pressures from all sections of the population.' Further, 'a panchayat has a larger authority, both in tradition and in law, over the affairs of a village than any other organisation could have. If by linking up the village panchayat closely with development programmes village leadership can be successfully developed, co-operative activity will also be strengthened' [Planning Commission, 1953, p. 133]. The State Governments could consider any amendments that may be required in panchayat legislation to enable panchayats to assume responsibility for such functions as '(1) framing programmes of production for the village; (2) framing budgets of requirements for supplies and finance needed for carrying out the programmes; (3) acting as the channel through which, increasingly, Government's assistance other than assistance which is given through agencies like co-operatives reaches the village; (4) securing minimum standards of cultivation to be observed in the village with a view to increasing production; (5) bringing waste land under cultivation; (6) arranging for the cultivation of land not cultivated or managed by the

owners; (7) organising voluntary labour for community works; (8) making arrangements for cooperative management of land and other resources in the village according to the terms of the prevailing land management legislation; and (9) assisting in the implementation of land reform measures in the village'. According to the Plan, 'these and other similar tasks can be carried out with enthusiasm in the measure in which a village community becomes aware of its problems and of the power of its members, through mutual aid and cooperation, to solve them. The first aim of village leaders and of extension workers is, therefore, to stimulate an understanding of what needs to be done and of the means that lie at hand as well as a growing sense of common interest and responsibility for the welfare of every section of the village community' [Planning Commission, 1953, p. 134].

The First Plan also referred to the paucity of persons who could be elected to the village panchayats with the qualities needed for village reconstruction, such as good farmers engaged in improved agricultural practices, enthusiastic workers of the cooperative movement and persons whose main interest lay in constructive social work. The Plan stated that 'for village development programmes there should be provision for a small number of additional members to be appointed by the State Government or on its behalf, so that the panchayats enlarged in this manner function as village development agencies largely on the basis of consent and constructive leadership within the village'. The points emphasised in the Plan were '(1) the need for an appropriate agency in the village or as near the village as may be possible, (2) the desirability of having as members of the village body concerned with various aspects of village development, a few persons in addition to those who may be elected by vote, and (3) the need to use the village body as an effective agency for development in the village and in relation to the programmes sponsored by the Government' [Planning Commission 1953, Pp. 134-35]. Thus, without delegating the authority of implementation of the community development programmes to the

panchayats, the First Plan emphasised the need to strengthen panchayats for the welfare of every section of the village community.

#### *Progress of Panchayats during the First Five Year Plan*

All the States except Tripura, had enacted legislation for the establishment of statutory panchayats in the rural areas by the end of the First Five Year Plan, i.e., by March 1956. There were 1,23,670 Gram Panchayats covering more than half the total number of villages in the country. The progress measured purely in quantitative terms was more pronounced in Uttar Pradesh, Punjab, Mysore, Kerala and the erstwhile States of Madhya Bharat and Saurashtra where almost all villages were served by panchayats. The pace was somewhat slow in Assam, West Bengal, Orissa, Rajasthan and Andhra, while other States had made steady progress towards the goal. There were however substantial elements of instability and weakness present in a majority of the panchayats. Possibly not more than 10 per cent of the total number of panchayats were functioning effectively, roughly one half were average and the remaining about 40 per cent were working unsatisfactorily [Committee on Plan Projects, 1957, Pp. 1-2].

The pattern of organisation, constitution and jurisdiction of panchayats varied in the different States. The interplay of needs, resources available, and administrative convenience had produced a variety of policies under given local conditions. In the areas covered by the former States of Saurashtra and Madhya Bharat, there were three tiers of panchayats. The structure of panchayats in Madhya Bharat had gram panchayats as the base, kendra panchayats above them at the Block level and Mandal panchayats at the district level. In Saurashtra there were gram panchayats at the bottom, a Gram Panchayat Mandal whose functions were mainly advisory, and at the district level, the Gram Panchayat Madhyastha Mandal which was the apex body whose main functions related to the encouragement, supervision and coordination of the work of gram panchayats. Assam had primary village panchayats which acted as agents of the Rural

Panchayats constituted by indirect election and comprising a number of primary panchayats. West Bengal had the system of purely elected Union Boards; with the enactment of the Panchayat Act, 1956, a two tier system of gram panchayats and anchal panchayats was proposed in the State. In Madras and Madhya Pradesh, panchayats were classified into two or three categories on the basis of population and revenue.

Acts in most States provided that a panchayat be constituted for every village except where the Government could, if it thought fit, establish a panchayat for a group of contiguous villages or more than one panchayat for a big village. Bombay, Uttar Pradesh, Madhya Pradesh, Punjab and Saurashtra provided for single village panchayats; Bihar, Orissa, Madhya Bharat and Kerala had group panchayats, as far as possible. In Uttar Pradesh, with the creation of Gaon Samaj, a parallel body at the village level, under the provisions of the Zamindari Abolition and Land Reforms Act, it became necessary to coordinate their territorial jurisdiction and functions with the panchayats. Thus a panchayat was set up for every revenue village with a minimum population of 250. In Mysore, a minimum population of 2,000 was required for defining the range of villages to be brought under the panchayat system, while in Madras the number was 500 [Committee on Plan Projects, 1957, p. 3].

The functions to be performed by the village panchayats, as provided in the Acts, were judicial and administrative. The judicial functions were performed by ordinary village panchayats in Punjab and Jammu and Kashmir. In Punjab, where the gram panchayats were delegated with civil, criminal and judicial functions, a five-member Adalati Panchayat was elected for the performance of the afore-mentioned functions on behalf of the gram panchayat. In Uttar Pradesh and Assam, separate independent bodies were set up to perform judicial functions. In Bombay, judicial functions were performed by the Nyaya Panchayats specially set up for the purpose. The Nyaya Panchayats were authorised under the Acts to try minor criminal cases like theft where the value of the property did not exceed a certain amount, assault or use of criminal force, trespass, causing danger, obstruction, or injury to any

public way, etc., and civil suits for money due on contracts, suits for the recovery of property, suits for compensation for wrongfully taking, or injuring moveable property, etc.

The administrative functions covered a wide range, including municipal, village administration, cultural and social, and development activities including sanitation, conservancy, crop experiments, promotion of cottage industries, construction, maintenance and repair of wells, tanks, public roads, drains, etc., the maintenance and regulation of the use of public buildings and lands reserved for public use, control of fairs and bazaars, etc. In Assam, Bihar, Orissa and Saurashtra, the panchayats were also required to make arrangements for watch and ward. The actual performance of the panchayats was however generally limited to making arrangements for sanitation, conservancy, construction and repair of fair weather roads, provision of domestic water supply and street lighting. Even these simple and elementary civic functions were not being performed with a degree of efficiency over large areas. Only a small number of panchayats, particularly those situated within or near the Block areas had shown a zeal for development activities on any appreciable scale [Committee on Plan Projects, 1957, p. 4].

The panchayats were generally handicapped for want of adequate financial resources to meet the expenditure on their various activities. Although the Acts provided for the panchayats to obtain finance through levy of taxes, loans, fees, fines, grants, contributions from Government, etc., it was found that a majority of the working panchayats had an annual income not exceeding Rs 500 from all sources including Government subsidy. In Uttar Pradesh, the average annual income of a panchayat was less than Rs 200; but it was around Rs 350 when the limit of population for constituting a gaon sabha was 1,000. The figure for Madhya Pradesh was below Rs 250 and in Mysore by far the large majority of panchayats had an annual income below Rs 300. In Madras the average income of each of the 4,313 Class II panchayats from all sources was Rs 1,437 in 1952-53. Class I panchayats numbering 291 in the same year reported a substantially higher figure at Rs 31,753 excluding receipts on Capital

Account. The majority of panchayats in Bombay had an average income of over Rs 3,600 in 1954-55, and in Saurashtra of over Rs 2,000 in 1951-52. But these larger incomes were mainly explained by substantial grants given by the Government. There were three major aspects of the problem relating to finance, namely, inadequate resources allotted to panchayats under the Acts, a general reluctance to make use of the existing resources, and general inefficiency in tax administration. Not all panchayats levied even the compulsory taxes and fewer still collected them with any degree of efficiency. In Uttar Pradesh about 45 per cent of the taxes imposed over a period of eight years ending 1956-57 were realised and arrears at the end of 1956-57 were estimated at Rs 4.65 crore. In Bihar, Orissa and Madhya Pradesh, the collections did not exceed 25-30 per cent. In many cases, the *sarpanch* and *panchas* were among the defaulters. There were complaints of discrimination and even of deliberate victimisation. There was a general aversion to adopt coercive measures, which it was feared would make the panchayats unpopular [Committee on Plan Project, 1957, p. 7].

#### *Second Five Year Plan, 1956-61*

It was realised in the Second Plan that the pattern of district administration envisaged in the national extension and community development programme would remain incomplete unless village institutions were placed on a sound footing and entrusted with a great deal of responsibility for carrying out local programmes. The experience of setting up ad-hoc bodies in villages to implement development programmes had also reinforced this conclusion. The development of village panchayats on the right lines was, therefore, of significance. The village society was in a state of rapid transition 'under the impact of new developments including the growth of population, land reforms, urbanisation, spread of education, increase in production and improvement in communications. In emphasizing the interest of the community as a whole, and in particular the needs of those sections which were handicapped in various ways, it was felt that village panchayats

along with co-operatives could play a considerable part in bringing about a more just and integrated social structure in rural areas and in developing a new pattern of rural leadership' [Planning Commission, 1956, p. 151].

The Plan recommended that a statutory panchayat should be established in every village, especially in areas selected for national extension and community development projects. A tentative programme envisaged the setting up of 2,44,564 village panchayats by 1960-61. There was also need to review village boundaries, so that good efficient working village units with live panchayats could be evolved. The Plan distinguished between the administrative and judicial functions of the panchayats. The administrative functions could be divided between (1) civic, (2) development, (3) land management, and (4) land reforms. The judicial functions as also the civic functions of panchayats were to be embodied in the legislations in the different States.

As regards development functions, the Plan suggested the: (1) framing of programmes of production in the village; (2) in association with cooperatives, framing of budgets of requirements for supplies and finance for carrying out programmes; (3) channel for flow of an increasing proportion of government assistance reaching the village; (4) developing common lands such as waste lands, forests, abadi sites, tanks, etc., including measures for soil conservation; (5) construction, repair and maintenance of common village buildings, public wells, tanks, roads, etc.; (6) organisation of mutual aid and joint effort in all activities; (7) promotion of cooperative societies; (8) organising voluntary labour for community works; (9) promoting small savings; and (10) improvement of livestock.

The functions of panchayats in respect of land management were recommended as (1) regulation of the use of common lands such as waste lands, forests, abadi sites, tanks, etc.; (2) cultivation of lands set apart for the benefit of the village community, as in consolidation of holdings; (3) adoption of standards of good management and cultivation suitable for local conditions and their enforcement; and (4) association with the work of maintenance of land records.

With regard to land reforms, the Plan recommended the functions of panchayats as (1) determination of land to be allotted to owners and tenants on the exercise of rights of resumption for personal cultivation; (2) determination of surplus lands on the application of ceilings on agricultural holdings, and (3) redistribution of surplus lands arising from the imposition of ceilings [Planning Commission, 1956, Pp. 152-153].

It had been recognised in the First Plan that in the process of election of panchayats, a sufficient number of persons with qualities needed for village reconstruction (good farmers, co-operative workers and social workers) were not always elected. Similarly, the weaker sections of the population, such as the landless labourers, did not find themselves adequately represented in the panchayats. The First Plan recommendation of nomination of additional members had not been found to be free from defects. The Second Plan had, therefore, suggested that it would be desirable to empower village panchayats to co-opt a limited number of persons, say 2 or 3 in the case of smaller panchayats and up to one-fifth in the case of larger panchayats, representing the weaker sections as also persons capable of assisting in village reconstruction.

The Plan also referred to the financial problems faced by panchayats, particularly the very insignificant resources realised by them. It was, therefore, recommended that the State Governments could consider making grants to village panchayats in two parts, a basic proportion, say 15 to 20 per cent of the land revenue, with an additional grant extending upto say 15 per cent of the land revenue on condition that the panchayat raised an equal additional amount by taxation or voluntary contributions. The panchayat should also be assisted in developing sources of recurring income. It was felt that a proportion of the land revenue in each village should be assigned to the panchayat for local development. This would serve as a nucleus fund to be augmented by the panchayat from contributions in labour and money from members of the community.

As the coverage of the national extension service expanded, the work of village panchayats should be closely integrated with the programmes

adopted by Development Blocks. According to the Second Plan, the panchayats would have two sets of programmes for implementation, namely, those which were sponsored by the Government through extension workers and by District Boards through their agencies and those which were undertaken by the village community of its own volition and from its own resources in manpower, materials and money. Towards the former the village would have to find a share of the cost mainly in the form of labour. While both sets of programmes were vital, and the village panchayat was to be used wherever possible in carrying out the development programmes, it was felt that an important test of the success of the panchayat as an institution was the proportion which the second set of programmes bore to the first. The true significance of the panchayats lay in its role in mobilising the contribution of the community. It was also desirable that where village panchayats undertook activities such as minor irrigation works, land development, soil conservation, etc., they were to be given the assistance which was commonly made available to the individuals under various schemes. The Plan stressed that local communities should be encouraged to undertake joint activities to the maximum extent possible [Planning Commission, 1956, p. 155].

*Study Team on Community Project and National Extension Service, 1957*

In 1956, that is, with the inception of the Second Five Year Plan, the National Development Council constituted a Committee on Plan Projects, for securing the maximum possible economy and avoiding wastage owing to delays and inefficiency, with the large and growing outlay for the Second Plan, both on revenue and capital account. Accordingly, the Committee on Plan Projects appointed in January 1957, a Team for the Study of Community Projects and National Extension Service, with Shri Balvantray G. Mehta as Chairman. The terms of reference of the Study Team were to study and report on the Community Projects and National Extension Service with a view to economy and efficiency. The Study Team submitted its report in November, 1957.

The Team recommended the merging of the Community Development and National Extension Services into a single phase and the staggering of the programme into the Third Plan. The Team also recommended that emphasis in the programme should shift without delay to the more demanding aspects of economic development; the priorities as between the different activities should be: supply of drinking water, improvement of agriculture and animal husbandry, cooperative activities, rural industries and health, followed by all others. Further, Government should divest itself completely of certain duties and responsibilities and devolve them to a body which would have the entire charge of all development work within its jurisdiction, reserving to itself only the functions of guidance, supervision and higher planning. Such a body at the Block level should be an elected self-governing institution with its jurisdiction co-existent with a Development Block. The institution could be called a Panchayat Samiti, which should be constituted by indirect elections from the village panchayats. Each of the municipalities lying as enclaves within the jurisdiction of a Block should elect from amongst its own members one person, as a member of the Panchayat Samiti. State Governments may convert predominantly rural municipalities into panchayats. 10 per cent of the number of elective seats of the Panchayat Samitis could be filled by the representatives of directors of cooperatives, wherever the extent and importance of the local cooperative organisations in a Block was justified. The Panchayat Samitis should have a life of five years and should come into being sometime in the third year of the Plan period. The functions of the Panchayat Samiti recommended by the Study Team included development of agriculture in all its aspects, improvement of cattle, promotion of local industries, public health welfare work, administration of primary schools, and collection and maintenance of statistics. It should also act as an agent of the State Government in executing special schemes of development entrusted to it. Other functions should be transferred to the Panchayat Samitis only when they were functioning as efficient democratic institutions.

The sources of income for the Panchayat

Samitis recommended by the Study Team included (i) percentage of land revenue collected within the Block, (ii) cess on land revenue, (iii) tax on professions, (iv) surcharge of duty on transfer of immovable property, (v) rent and profit accruing from property, (vi) net proceeds on tolls and leases, (vii) pilgrim tax, tax on entertainment, primary education cess, proceeds from fairs and markets, (viii) share of motor vehicle tax, (ix) voluntary public contributions, and (x) grants made by the Government. Grants-in-aid by State Governments and all Central and State funds spent in a Block area should also be assigned to Panchayat Samitis [Committee on Plan Projects, 1957, Pp. 125-126].

Together with the establishment of the Panchayat Samitis, the Study Team prescribed its relations with the village panchayats; the Team also redefined the functions and resources of village panchayats. The main sources of income of village panchayats were recommended as property or house tax, tax on markets and vehicles, octroi or terminal tax, conservancy tax, water and lighting rate, income from cattle ponds, grants from the Panchayat Samiti, and fees charged from the registration of animals sold, etc. The village panchayats were to be used as the agency for the collection of land revenue and be paid a commission. The village panchayats should also be entitled to receive from the Panchayat Samiti the statutory prescribed share upto three-fourths of the net land revenue assigned to the latter [Committee on Plan Projects, 1957, Pp. 127-128]. Local resources raised by village panchayats should in future be used for development purpose, instead of the maintenance of watch and ward staff. Legislation should be enacted that persons who had not paid taxes should be debarred from exercising franchise in panchayat election, or from continuing as a panchayat member.

The compulsory duties of village panchayats were recommended by the Study Team as provision of water supply, sanitation, lighting, maintenance of roads, land management, collection and maintenance of records and other statistics and the welfare of backward classes. The panchayats would also act as the agent of the Panchayat Samiti in executing any scheme

entrusted to it. The budget of the village panchayat would be subject to scrutiny and approval of the Panchayat Samiti, the chief officer of which would exercise the same power in regard to the village panchayat, as the collector would be required to exercise with the Panchayat Samiti [Committee on Plan Projects, 1957, Pp. 127-128].

While the village panchayat would be the body at the village level and the Panchayat Samiti at the Block level, the Study Team recommended that to ensure necessary co-ordination between Panchayat Samitis, a Zila Parishad should be constituted at the district level, consisting of the presidents of the Panchayat Samitis, MLAs and MPs representing the area, and the district level officers. The collector of the district would be the chairman and one of the officers would act as secretary of the Zila Parishad. The district level officers represented on the Zila Parishad would include those concerned with medical, public health, agriculture, veterinary, public health engineering, education, backward class welfare, public work, and other development departments. The functions of the Zila Parishads would be (a) to examine and approve the budgets of the Panchayat Samitis; (b) where funds were allotted by the Government for the district as a whole, their distribution between the various Blocks; (c) to co-ordinate and consolidate the Panchayat Samiti plans, annual as well as quinquennial; (d) to consolidate the demand for grant for special purposes by the samitis and forward to the Government; (e) to supervise the activities of the Panchayat Samiti; and (f) to perform certain disciplinary functions in regard to specified categories of the staff of the Panchayat Samitis.

In the planning and execution of community development programmes, the Study Team recommended that the people's local representatives assisted by the development staff should work out and execute the details of the plan, keeping in view the broad objectives, the general pattern and the measure of financial and technical supervisory assistance available. The district and Block level local representative organisations should work out priorities and phasing within the framework prescribed, subject to certain guidelines. All schemes sponsored by different departments, in addition to those under the Block

budget and financed out of state funds, including loans, and/or people's contributions should be integrated with the Block budget schemes at all levels and an integrated plan for the entire state should be evolved. Within the Block, the Panchayat Samiti or the Block advisory committee should break the integrated plan into smaller units, e.g., Gram Sevak circles, villages and families [Committee on Plan Projects, 1957, p. 130].

*Progress of Panchayati Raj Programmes, 1956-61*

The recommendations of the Study Team were considered by the Standing Committee of the National Development Council in January 1958. The Standing Committee affirmed the objective of introducing a democratic structure of administration within the district, above the village level, and approved of the general principle of giving responsibility for development to representatives of the people within the district. The precise manner in which the principle was to be applied was left to the States to work out according to local conditions and requirements [Ministry of Community Development, 1958, Pp. 1-2].

With the decision taken to transfer the authority of rural development work to peoples' institutions at and below the district level, the subject of village panchayats was transferred to the Ministry of Community Development from March 1958. By the end of the Second Five Year Plan, nearly all the States had accepted the concept of Panchayati Raj. Rajasthan and Andhra had introduced Panchayati Raj, with the three-tier system, namely, the village, the Block and the district in their respective States in 1959. 'Both the elected representatives and the officials had settled down to work the system and there was great consciousness and determination among the people as well as the elected representatives, side by side with great enthusiasm on the part of the officials to make it a success. A new bond of relationship was fast growing between the officials and the people and it was one of accommodation, goodwill and understanding [Ministry of Community Development and Co-operation, 1961, p. 27].

Assam and Mysore had introduced the scheme during 1960-61. Punjab had held elections of the panchayats all over the State to fulfil the programme of constituting Panchayat Samitis and Zila Parishads in all the districts by the middle of May 1961. Orissa had constituted 307 Panchayat Samitis covering the entire State by January 1961. The Zila Parishads were expected to be set up by April 1961. Madras had completed the first phase of its programme of setting up Panchayat Samitis in 75 Blocks. The Jammu and Kashmir Panchayat Act, 1958 enforced from April 1959, provided for panchayats at the village level and Panchayat Advisory Boards at the Block level. The States of Bihar, Gujarat, Kerala, Madhya Pradesh, Maharashtra and Uttar Pradesh had introduced Bills in their respective legislatures for a three-tier system of Panchayati Raj.

#### *Third Five Year Plan, 1960-61 - 1965-66*

For ensuring the effective and successful working of Panchayati Raj Institutions, the Third Five Year Plan recommended that (i) while developing institutions at the higher levels, the greatest stress should continue to be laid on the work of the Gram Sabha and the Panchayat at the village level; (ii) technical officers at the district level should endeavour to make their advice and assistance available to extension officers at the Block level and to the Panchayat Samitis for the initial preparation of programmes and schemes before decisions were taken; (iii) to assist the Panchayat Samiti effectively, the Block Development Officer and Extension Officials must continue to function as a team, the Block Development Officer providing the necessary co-ordination and leadership, and Extension Officers in different fields participating actively in formulating programmes and schemes for the consideration of the Panchayat Samiti and its Standing Committees, executing them impartially in accordance with the rules, and ensuring that the supplies and services needed were organised efficiently. Adequate supervision over the work of the village level workers was essential; (iv) in the work of Panchayat Samitis, the main stress should be on the preparation and implementation of carefully considered Block

plans, so that along with the village plans, they provide the essential means for securing intensive and continuous development; (v) the technical departments at the State level should transmit the best guidance and experience available in each field of development, provide for adequate training programmes for the elected representatives, and assist them generally in fulfilling the onerous responsibilities which Panchayati Raj placed on them; and (vi) the Collector of the district had the duty of ensuring coordination at the district level between the Zila Parishad and the technical officers in different fields, close contacts between the latter and the Panchayat Samitis and Extension Officers at the Block level, and a continuing flow of technical advice and guidance from departments at the State level [Planning Commission, 1962, Pp. 339-340].

The Plan also raised the wider question of the reorganisation of district administration, with the introduction of Panchayati Raj, in view of the multiplicity of activities expected to be undertaken by the panchayati raj organisations. 'When the community development programme was taken up, the extension staff had been superimposed on the traditional district administration without adequate connecting links. With the advent of Panchayati Raj, the functioning of Panchayat Samitis included both community development activities and several activities hitherto entrusted to Local Boards. There was therefore considerable over-lapping of activities which called for some measure of rationalisation and fresh definition of functions and relationships' [Planning Commission, 1962, Pp. 341-342].

#### *Progress During the Third Plan*

By 1965-66, 2,12,424 village panchayats were operating in the country. The other two tiers, - the Panchayat Samitis at the Block level and Zila Parishads at the district level, - had been constituted in all the States except Madhya Pradesh, Kerala, Jammu and Kashmir, parts of Bihar and Nagaland. In Bihar these bodies had been set up only in Ranchi, Bhagalpur and Dhanbad districts. By the end of March 1966 there were 3,490 Panchayat Samitis and 250 Zila Parishads in the



country [Ministry of Food, Agriculture, Community Development and Cooperation, 1967, Pp. 37-38]. There was not much diversity in the functions and powers of the village panchayats and Panchayat Samitis. But there was considerable variations in the functions and powers of Zila Parishads in the different states. In Andhra Pradesh, Assam, Bihar, Madhya Pradesh, Madras, Orissa, Punjab, and Rajasthan, the Zila Parishads' role was mainly of supervisory, advisory and coordinating nature, with functions such as scrutiny and approval of budgets of Panchayat Samitis, distribution of government funds among Samitis, coordination and consolidation of plans, etc. Some executive functions such as establishment and maintenance of secondary, vocational or industrial schools were entrusted to the Zila Parishads in these States. In Gujarat, Maharashtra and Mysore, the Zila Parishads had been entrusted with executive functions such as (a) preparation of village plans and coordination of development schemes, (b) establishment, maintenance and management of and financial assistance to agricultural schools, subject to certain technical and other limitations, (c) establishment and maintenance of veterinary hospitals and control of contagious diseases, (d) construction, maintenance and repairs of district roads and bridges, (e) construction, renovation and maintenance of minor irrigation schemes, (f) organisation of marketing facilities for products of industrial estates, cottage and village industries, etc., (g) establishment, maintenance, management, inspection and visiting of secondary schools, subject to such technical and administrative limitations as may be prescribed, and (h) establishment and regulation of district fairs and festivals. In Uttar Pradesh and West Bengal, the Zila Parishads had both obligatory and discretionary functions [Ministry of Community Development and Cooperation, 1965, Pp. 63-74].

The Third Plan had called for rationalisation of district administration, with the introduction of Panchayati Raj and coordination of activities of the different executive bodies in the rural sector. Accordingly, a number of Study Teams and Working Groups were set up during the Plan period.

#### *Study Team on Nyaya Panchayats*

The Study Team on Nyaya Panchayats under the Chairmanship of Shri G.R. Rajagopal which submitted its report in April 1962, recommended the separation of the judicial functions from the executive functions of Gram Panchayats and the setting up of Nyaya Panchayats for groups of villages. The Nyaya Panchayats could be constituted by the method of indirect election, by the Gram Panchayats situated in the Nyaya Panchayat circle. The jurisdiction of Nyaya Panchayats should be exclusive. The civil jurisdiction may be confined to simple money and other suits. Criminal jurisdiction should be limited to petty matters where a punishment in the form of a fine would be adequate corrective. Nyaya Panchayats should not be given the power to award imprisonment either substantive or in default of payment of fine. It was neither necessary nor desirable to confer on Nyaya Panchayats power to issue prohibitory orders or to demand security for keeping the peace or for good behaviour, etc. A Nyaya Panchayat should make every endeavour to bring about amicable settlement between the parties to dispute through conciliation before taking up a case for adjudication [Ministry of Community Development, Panchayati Raj and Cooperation, 1962, Pp. 152-155]. The recommendations of the Study Team were generally accepted by the State Governments and, by the end of the Third Five Year Plan, Nyaya Panchayats were functioning in Bihar, Gujarat, Haryana, Madhya Pradesh, Maharashtra, Orissa, Punjab, Rajasthan and Uttar Pradesh and in parts of Kerala, Mysore and West Bengal.

#### *Study Team on Gram Sabha*

Another team, with Shri R.R. Diwakar as Chairman was setup in 1962, to study the working of the Gram Sabha (village assembly), Gram Panchayat and the Panchayat Samiti with special reference to: (a) the extent to which the Gram Panchayat was influenced in its policies and decisions by the views and mandates of the Gram Sabha, and the extent to which the Gram Sabha

was involved in the implementation of programmes; and (b) the extent to which the powers and functions of *Sarpanchas* of Village Panchayats and *Pradhans* of Panchayat Samitis were consistent with the institutional functioning of the panchayats and Panchayat Samitis. The Team was expected to suggest measures to ensure that Gram Sabhas were built up as the base of Panchayati Raj and *Sarpanchas* and *Pradhans* functioned institutionally.

The Study Team submitted its report in April 1963. It recommended the strengthening of panchayats as an indirect measure of strengthening Gram Sabhas. The panchayats should deal with mutations, disposal of agricultural and grazing grounds, forest rights and irrigation, water distribution, etc. Villagers deriving benefits from works executed through *Shramdan* should pay betterment levy to panchayats. (These recommendations were however not found acceptable to the State Governments) The Gram Sabhas should have a population of 1,000 to 1,500; each Gram Sabha meeting should have a quorum of 10 per cent of the population. The Team also recommended the procedures of election of members, including Scheduled Castes and Scheduled Tribes on to the panchayats, the tenure of the elected members, the election of *Sarpanchas* on to Panchayat Samitis, etc. [Ministry of Community Development and Cooperation, 1963, Pp. 119-120]. Most of the States had taken follow-up action on these aspects.

#### *Working Group on Panchayati Raj Administration*

During the same year (1962), a Working Group on Panchayati Raj Administration under the Chairmanship of Dr. Ram Subhag Singh was constituted. Among the steps recommended by the Working Group were (a) vesting of full powers to State Cabinet Committee on Agricultural Production; (b) an integrated Department of Agricultural Production and Rural Development; (c) the constitution of agricultural production committees at Zila Parishad level with the Collector as Chairman; and a senior class I officer of the status of a Deputy Director as secretary; (d)

the constitution of agricultural production committees at the Block level with the Block Development Officer (BDO) as secretary; (e) the reservation of at least 50 per cent of the BDO's posts for promotion from Extension Officers of integrated departments; (f) village level workers to devote all their time to agricultural programmes and their work schedule to be drawn up by the Agricultural Extension officers; and (g) the separate single-purpose worker under the Intensive Area Development Programme to be merged with the village level workers cadre [Ministry of Community Development and Cooperation, 1964, p. 72]. The recommendations of the Working Group were accepted in varying degrees by the State Governments.

#### *Study Group on Budgeting and Accounting Procedure of Panchayati Raj Institutions*

The Study Group to examine the working of the budgeting and accounting system followed in respect of the financial transactions of Panchayati Raj bodies at various levels was set up in October 1962 under the Chairmanship of Shri M. Ramakrishnaya. The Group submitted its report in April 1963. The Group recommended that each Development Block should have comprehensive schematic budget corresponding to the period of the Five Year Plans, incorporating not only the Community Development funds but also Plan and non-Plan funds from other Departments, besides resources raised by the Samitis. The States should draw comprehensive budgets for each Plan period, the exercise being initiated first at the State level and then carried down to the district, Block and village levels. The Group also advised on the simplification of the budgetary system at all levels, the manner of release of funds to the panchayati bodies, the maintenance of accounts and the procedure of implementation of schemes, etc. [Ministry of Community Development and Cooperation 1963, Pp. 122-125]. The recommendations of the Study Group were discussed at the annual conference on Community Development and Panchayati Raj in July-August 1963 when the necessity of examining the system of audit obtaining in the different States was felt,

in view of the substantial devolution of powers to Panchayati Raj bodies and the considerable investment of public monies. Accordingly, a Study Team was set up, headed by a representative of the Controller and Auditor General of India to examine the matter and suggest a basic pattern of audit suitable to all States, allowing for local modifications.

#### *Study Team for System of Audit of Panchayati Raj Accounts*

The Study Team set up under the Chairmanship of Shri R.K. Khanna, Accountant General, Central Revenues, to examine the practical working of the system of audit of Panchayati Raj accounts in different States and to suggest a basic pattern which, with suitable modifications, could be adopted by all States. The Study Team presented its report in March 1965. The Team gave its suggestions on audit staff and audit organisation, procedure for audit, surcharge, follow-up of audit, etc. [Ministry of Community Development and Cooperation, 1965, Pp. 88-90].

#### *Study Team on Panchayati Raj Finance*

The Study Team on Panchayati Raj Finance was set up in July 1962, under the Chairmanship of Shri K. Santhanam. The Team submitted its report in July 1963. The more important recommendations of the Team included (a) making house tax, profession tax and vehicle tax compulsory and prescribing maximum and minimum rates for them; (b) matching grants to be given on the basis of the entire tax demand of the panchayats and assistance to be given at higher rates to panchayats in poorer areas; (c) public lands, trees, ponds and tanks along with fishery rights, unreserved forests, choultries, rest houses, etc., to be transferred to panchayats and sale of immovable property by panchayats to be subject to approval; (d) pilgrim tax to be levied by Samiti or Parishad; part of the yield to be given to the concerned panchayat and the remainder to be used for the benefit of the Samiti/Parishad area; (e) the whole or part of the entertainment tax in rural areas to

be shared by the State Government with panchayats and Samitis; and (f) big tanks, large plantations, big fairs, markets, ghats, ferries, etc., may be taken up by the Samiti and the proceeds shared with the panchayats [Ministry of Community Development and Cooperation, 1964, Pp. 110-113].

#### *Committee on Panchayati Raj Elections*

Another Committee headed by Shri K. Santhanam was constituted in July 1964 to study the mode of Panchayati Raj election and the measures for representation of special interests. The particular aspects on which the Committee was requested to make recommendations included the strength and composition of, and the method of elections to, Panchayat Raj bodies, method of election of the office bearers, co-option, representation to the weaker sections, association of members of Parliament and State legislatures, terms of membership and periodicity of elections to Panchayati Raj bodies, role of political parties in elections, the practicability of securing unanimity in elections, and measures to ensure fair elections, and the desirability of setting up State level Commissions for the purpose. The Committee presented its report in March 1965 [Ministry of Community Development and Cooperation, 1965, Pp. 75-78].

According to the Committee, the village panchayats should comprise 9-19 members and all the *Sarpanchas* would be ex-officio members of the Panchayat Samiti. The size of the Samiti would, however, be kept between 20 and 40, by either grouping the smaller panchayats, or providing for additional representatives from panchayats, depending upon the number of panchayats in the Samiti area. The Zila Parishad would include all the Chairmen of the Samitis; in addition, the Samitis would elect additional members. To ensure adequate representation for women and members from Scheduled Castes and Scheduled Tribes, the Santhanam Committee had suggested reservation at the panchayat level and co-option at the higher levels, the number of seats reserved for Scheduled Castes and Scheduled

Tribes members being dependant on their population. Members of the Lok Sabha and MLAs should be members of the appropriate Parishads and Samitis, without right to vote or hold office [Ministry of Community Development and Cooperation, 1965, Pp. 4-6 and 75-78]. The Committee also submitted recommendations on institutional representation, and individual nominations on Panchayati Raj bodies, election of members at village panchayat levels, compulsory voting of all members in panchayat elections, Samiti chairmen and Parishad president elections, etc.

*Agenda Note for Chief Ministers Conference, June 1968*

The role played by the Community Development and Panchayati Raj movement was reviewed at the conference of Chief Ministers, and State Ministers on the subject held at Madras in June 1968. In the background note, submitted for the consideration of the Conference, it was pointed out that the expectation, that the three-tier structure of Panchayati Raj would have been established all over the country by the end of the Third Plan period, had not been fulfilled. Even where the structure was in position there had been reservations in practice about entrusting development programmes, as envisaged under the law, to the Panchayati Raj bodies. The resources available to the Panchayati Raj institutions, especially at the middle and higher levels, were for the most part, severely limited; incentives for a larger concerted effort in the shape of matching grants and otherwise were rarely available. With scanty resources at their command, those bodies continued to be heavily dependent on such governmental assistance as was forthcoming. Both Community Development and Panchayati Raj thus stood in a state of disarray. There was recurring recourse to the idea of separate departmental hierarchies each making its own effort for development work in the field [Ministry of Food, Agriculture, Community Development and Cooperation, 1968, Pp. 26-27].

*Fourth Five Year Plan, 1969-74*

It was pointed out in the Fourth Plan, that the programmes of local development continued to be dependent on Government initiative and even more so on Government funds. Where funds were lacking, activities languished and the staff remained almost supernumerary. Where, however, administrative and financial support had been forthcoming, the combined contribution of Panchayati Raj and Community Development had been significant in the formulation and implementation of local development plans. There had also been a large measure of coordination and integration of the field staff. In certain instances, the Panchayati Raj institutions had for their part, made attempts to raise increasingly large resources through tax measures. In the majority of cases, however, local finance had continued to play very little part in local development [Planning Commission, 1970, Pp. 228-229].

Despite these drawbacks, the Fourth Plan felt that the Community Development Programme and Panchayati Raj Institutions had provided a new dimension to rural development and introduced a structural change of considerable importance in the district administration. Within the limitations of resources, the programme had attempted to do something which in many cases, had never before been attempted. Improvement of agriculture had remained in the forefront throughout. Investment from the available Block funds on agricultural development had over the years almost equalled the provisions for all other sectors of development taken together. In many States, the Block organisation had been virtually the only field agency for carrying out development programmes. There had been sizeable contribution from the local communities to the development effort. It was therefore felt that while there could be considerable flexibility in regard to the type of organisation, contents of programme and extent of resources, the need for an integrated approach to rural development, including coordination between official and non-official agencies, remained basic. Also

important was a continued emphasis on priority programmes such as agriculture and family planning [Planning Commission, 1970, Pp. 228-229]. The Plan referred to the outlays in the State Plans for community development programmes totalling to Rs 84.69 crore and stressed the need to ensure that these funds would be supplemented by resources mobilised by Panchayati Raj Institutions, and simultaneously increasing devolution of programmes and resources by the States. The fuller and more active involvement of the Panchayati Raj Institutions in the process of economic development and social advance was also thought necessary. The institutions should be assisted to build up their own revenue-yielding assets. The administrative apparatus at the district, Block and village level had to be integrated and, where necessary, strengthened. The integration had to comprise not only the staff of the Community Development and Panchayati Raj Institutions but also normal departmental staff dealing with all development schemes of a local character. At the same time, the administrative, financial and other procedure relevant to these institutions called for a careful periodic review to ensure that they remained attuned to the responsibilities devolving on them [Planning Commission, 1970, Pp. 229-230].

*Study Team for the Role of CD and PR Agencies for Land Reforms*

During the Fourth Plan period, a Study Team had been appointed to examine the role of Community Development and Panchayati Raj bodies in the basic land reforms measures. The Team mentioned in its Report that it may not be appropriate to invest the Panchayati Raj bodies with statutory executive functions during their present stage of evolution. They could, however, be associated with advantage in an advisory capacity, with various processes connected with the maintenance of land records. The Team was also of the opinion that the Panchayati Raj Institutions could help foster among the tenants

awareness of their rights [Ministry of Food, Agriculture, Community Development and Cooperation, 1970, p. 15].

*Progress of Panchayati Raj During the Fourth Five Year Plan*

By April 1974, the three-tier system of panchayats was in operation in Andhra Pradesh, Assam, Bihar (in 8 districts only), Gujarat, Haryana, Himachal Pradesh, Karnataka, Madhya Pradesh, Maharashtra, Orissa, Punjab, Rajasthan, Tamil Nadu, Uttar Pradesh, West Bengal and Arunachal Pradesh. Only the Gram Panchayats were functioning in Jammu and Kashmir, Kerala, Manipur and Tripura and in Andaman and Nicobar Islands, Chandigarh, Delhi and Goa, Daman and Diu. Nagaland had area, range and tribal councils. There were in all, 219,892 village panchayats in India covering 5,44,355 villages and a population of 406.84 million. In addition 3,863 Panchayat Samitis and 201 Zila Parishads were also functioning. It was found that the efficient working of the Panchayati Raj Institutions depended upon the powers and responsibilities delegated to them not only from the relative state legislations but also from the procedures - administrative and financial - laid down by the state governments to give effect in practice to the statutory provisions. States like Maharashtra, Gujarat and Tamil Nadu where Panchayati Raj had struck roots, were also among the states who had entrusted the institutions with programme responsibilities for a wide and growing range of activities under the State Plans. The Central Government continued to urge upon the State Governments that the need for optimum decentralisation of programmes and resources on Panchayati Raj Institutions was of basic importance towards their viability [Ministry of Agriculture and Irrigation, 1975, p. 17].

In the matter of implementation of schemes, generally, the cadre authority for the Block development officer was the Department concerned with Community Development/Rural Development and Panchayati Raj in the States, while the extension officers belonged to the cadre

of respective subject matter departments in the State. The Block development officer/chairman of the Panchayat Samiti exercised administrative control over Block extension staff in most of the States, although there were deviations in some States from the general pattern. While therefore the panchayat organisations with people's support formed the integral part of rural development programmes, the trained extension workers acted as catalytic agents in the implementation of these programmes by imparting knowledge and techniques to the village at individual levels. They also functioned as motivation and mobilisation agencies for social action programmes [Ministry of Agriculture and Irrigation, 1975, p. 5].

The Panchayati Raj institution was also found to foster a climate of community spirit and activity in spite of divergences in legislative coverages in different States, their constitution and working in different atmospheres. A necessary condition of the effective functioning of Panchayati Raj Institutions was that their strength as units of representative local development administration should be regularly renewed through the process of periodical general elections. It was however, found in 1974 that elections to Panchayati Raj bodies were overdue in the States of Bihar, Kerala, Rajasthan and West Bengal [Ministry of Agriculture and Irrigation, 1975, p. 18].

#### *Fifth Five Year Plan 1974-79*

The Fifth Five Year Plan recognised that rural development should include agricultural development in its widest sense so as to embrace, besides crop production, all its allied activities. This integrated development should encompass both spatial and functional integration of all relevant programmes bearing on increased agricultural production and reduction of unemployment and underemployment among small farmers and agricultural labour. Minimum needs programme was to be implemented on a massive scale during the Fifth Plan. These programmes would cover a large number of developmental activities spread over a wide area. There would still be some developmental needs of a purely

local nature particularly in the sphere of social action to be covered. The aim was towards all-round development and not confined to increasing production alone. People's participation in these developmental programmes was vital for their success. The Community Development Agency and Panchayati Raj Institutions should have adequate credibility and viability if they were to play their role effectively as instruments of change and raise among the rural people the desire for a better living. It was in this context that the Community Development and Panchayati Raj Institutions should be suitably reoriented and strengthened to become instruments of social and economic change [Planning Commission, 1973, Pp. 86-87]. The Fifth Plan recommended the review of (i) the size and viability of gram panchayats, (ii) the suitability of the Panchayat Samiti or the Zila Parishad as the best agencies for carrying out these programmes, and (iii) the specific programmes the Panchayat Samiti or Zila Parishad could and should administer. Efforts would also have to be made to attract institutional finance for augmenting the resources of Panchayati Raj bodies [Planning Commission, 1973, p. 87].

#### *Working Group on Block Level Planning, 1978*

In November 1977, the Planning Commission set up a Working Group on Block Level Planning with Prof. M.L. Dantwala as Chairman. In its report submitted in 1978, the Working Group considered the role of Panchayati Raj Institutions in the matter of control, guidance and supervision of Block level planning. The Group felt that two problems needed to be sorted out. 'First, in a large number of states, Panchayati Raj Institutions were either non-existent or were in a moribund state. This reality had to be reckoned with in making any recommendation which was meant for immediate implementation. Secondly, there was a widespread feeling that, by and large, the Panchayati Raj Institutions did not reflect the interests and needs of the weaker sections of the rural community. An extreme view was that they in a fact obstructed the flow of benefits to the

weaker sections. Given the structure of ownership of land and other assets, in the rural (and urban) areas, powerful ideological commitment would be needed for implementing a plan deliberately biased in favour of the poor. Such commitment did exist at the level of national leadership. However, the Group were not sure in what measure it had percolated deep down to the district or Block level. Therefore, the decision in this regard should be taken after a proper appraisal of the genuinely representative character of the Panchayati Raj Institutions' [Dantwala, 1978, p. 9].

Even before the Plan document was released, 'in the development programmes at the village level and the urgency regarding their fuller participation in the process of rural development, a high powered Committee under the chairmanship of Shri Asoka Mehta was set up in December 1977 to assess the weakness of these bodies and suggest measures to strengthen them'. The terms of reference of this Committee were: '(1) to review the existing situation regarding democratic decentralisation in the States and the Union Territories, and the working of the Panchayati Raj Institutions from the district to the village levels so as to identify shortcomings and defects. In particular, to examine the working of these institutions in respect of: (a) mobilisation of resources; (b) planning and implementation of schemes for rural development in an objective and operational manner, and in looking after the interests of the weaker sections of society. (2) To examine the methods of constituting the Panchayati Raj Institutions including the system of elections, and to assess their effect on the performance of the Panchayati Raj system. (3) To suggest the role of Panchayati Raj Institutions, and the objectives which could be attained through them, for integrated rural development in the future. (4) To suggest measures for reorganising the Panchayati Raj system, and removing the shortcomings and defects, with a view to enable these institutions to fulfil their future role. (5) To recommend the form and content of the relationship that should exist between the Panchayati Raj Institutions, the official administrative machinery and the cooperative and voluntary

institutions involved in rural development. (6) To make such other recommendations, including those on financial matters, as may be entrusted to the Panchayati Raj Institutions' [Ministry of Agriculture and Irrigation, 1978, Pp. 6-7].

#### *Committee on Panchayati Raj Institutions, 1978*

The Committee submitted its report in August 1978. Reviewing the working of the Panchayati Raj Institutions in the country, the Committee mentioned that: 'in Assam, there have been shifts in the tiers and functions assigned; the prevalent ones are the Mohkuma Parishad at the sub-divisional level and the panchayat with a population of well over 15,000. In Andhra Pradesh, the Zila Parishads, endowed with limited executive functions, have shown encouraging results in areas like education; the performance of Panchayat Samitis too has been noticeable. In Bihar, the Zila Parishads were introduced only in 8 districts, but were soon given up. In Rajasthan, which, with Andhra Pradesh, was the first to introduce Panchayati Raj, the Samiti tier worked with enthusiasm in the initial phase. Tamil Nadu and Karnataka do not have the Zila Parishad, in the sense of a body endowed with executive functions; but the Samitis/Taluka Boards there have done well. The performance of the Samitis in Tamil Nadu, in regard to education, water supply, roads and nutrition, has received wide appreciation. In Kerala, where there were only Village Panchayats but some of a size which could amount to half a Block, the working has been extremely satisfactory in the field of many municipal and civic functions; it is worth noting that, in spite of different political parties being represented on the elected body, there was the needed harmony in implementing the programmes assigned to them as also in monitoring certain developmental projects. In Uttar Pradesh, a large number of small panchayats were set up together with Zila Parishads with very limited powers. They could not achieve much owing to extreme paucity of powers and resources. In Madhya Pradesh, the Act embodying the scheme of democratic decentralisation was sought to be

implemented in a piecemeal manner - an approach that proved counter-productive. As far as West Bengal is concerned, it has weaned away from what seemingly was a four-tiered structure to a three-tiered one with larger gram panchayats. Deviating from the Balvantray Mehta report, a three-tier structure with the first point of decentralisation at the district level was organised in Maharashtra and Gujarat and it has functioned effectively, particularly in the field of decentralised planning and development. The District Councils in North Eastern India have features which are worth studying'.

'The story of Panchayati Raj has been a story of ups and downs. It seems to have passed through three phases: the phase of ascendancy (1959-64); the phase of stagnation (1965-69); and the phase of decline (1969-77)'.

'A number of developments in the past have conspired to undermine the Panchayati Raj structures and made them ineffective. In fact, except in Maharashtra and Gujarat, the PRIs have been rarely given an opportunity to take up planning or implementational work on a sizeable scale. Broadly speaking, the miniscule programmes which were assigned to village panchayats or the few items of work which were part and parcel of the Community Development Programme were handed over to the newly elected Panchayati Raj Institutions. The essential idea that all developmental activities should flow only through the Block level organisation lost ground, though Panchayat Samiti as a key unit of decentralisation was, in most cases, coterminous with the Block. In practice, there was a movement in the opposite direction. Schemes like Small Farmers Development Agency (SFDA) or Drought Prone Areas Programme (DPAP) or Intensive Tribal Development Project (ITDP) were not brought within the purview of the elected Zila Parishads either in Gujarat or in Maharashtra. The staff under the Zila Parishad would execute the schemes though the programmes were kept outside their orbit. Again, in Maharashtra, the planning work was entrusted to a body outside the Zila Parishad under the chairmanship of a Minister. Further, in the process of implementation of

the transferred activities, here and elsewhere, a number of orders and directions by the State Government led to the gradual development of subsidiary legislation which would tend to curtail the decision making powers of the elected bodies. The staff spared by the State to the district and lower bodies also gradually came to consist of officers who were not wanted by the State Governments. There was also the phenomenon of the tapering off of the Plan allocation resources contributing to, as also symbolising, the decline of Panchayati Raj. Finally, 'the quantum of own resources contemplated for the panchayats were both meagre and their potential also was not exploited by the Panchayati Raj Institutions in good measure'.

'Will for strengthening the PRIs further weakened with the demands of developmental programmes being kept out of its orbit becoming stronger. The tempo of development administration in seed supplies, fertilisers distribution, promotion of minor irrigation or enforcement of the civil supplies regulations, procurement of foodgrains, or performance of other welfare functions required such an intensive effort the year round that all the available staff at lower levels had almost to be requisitioned back by the parent departments. It is the vastness and growing complexity of developmental programmes that has sometimes been used as an excuse for by-passing the PRIs, in the name of their structural inadequacies, without PRIs being entrusted with these challenging tasks'.

'Bureaucracy has probably its own role in dissociating the PRIs from the development process. Several factors seem to have conditioned their perception. The system of line hierarchy would find favour with them as an organizational principle. The officers would feel that they are primarily accountable for results and financial proprieties to the State Government. The officials knew no better than to trust their own fraternity. They would, on the one hand, therefore, be averse to PRIs being entrusted with additional functions and on the other would not easily get adjusted to working under the supervision of elected representatives. The new developmental tasks and their



load also became such that the bureaucracy had to commandeer all the available staff and, in the process, withdrew what was available for the Block. Further, as a natural corollary of this pull for withdrawal, the influence of the field bureaucracy in decision-making waned with time and that of secretariat or departmental heads increased. The field bureaucracy was further handicapped because the elected representatives also quite often failed to own and work with them'.

'In sum, an overview of the national scene would indicate that the activities of PRIs were meagre, their resource base weak and the overall attention given to them niggardly. The functioning of the Panchayati Raj system thus became discouraging. As if this was not enough, some of the State Governments would postpone the holding of elections or supersede some of the important tiers of PRIs for one reason or the other. The lukewarm attitude of the political elite at higher levels towards strengthening of the democratic process at the grass roots was generally the crux of the matter. Of particular significance in this connection is the relative cooling off of enthusiasm of MPs and MLAs in some States towards Panchayati Raj, because they would perceive a threat in emerging Panchayati Raj leadership to their position in their respective constituencies. In the ultimate analysis, all this led to a weakening of political support to PRIs and of the administrative will to work through them'.

'Worst of all, there was lack of clarity in regard to the concept of Panchayati Raj itself and the objectives for which it should stand. Some would treat it just as an administrative agency; others as an extension of democracy at the grass roots level; and still others as a charter of rural local government. What is all the more intriguing is the fact that all these conceptual images would co-exist side by side tending to militate against each other at least in the short run. None of them could perhaps be seriously pursued. This led to a crisis of expectations all along the line' [Mehta, 1978, Pp. 3-6].

Despite these drawbacks, the Committee felt that Panchayati Raj had 'many achievements to its credit. ... Politically speaking, it became a process of democratic seed-drilling in the Indian soil, making an average citizen more conscious of his rights than before. Administratively speaking, it bridged the gulf between the bureaucratic elite and the people. Socio-culturally speaking it generated a new leadership which was not merely relatively young in age but also modernistic and pro-social change in outlook. Finally, looked at from the development angle, it helped rural people cultivate a development psyche' [Mehta, 1978, p. 8].

The Committee pointed out the changes that had been taking place in rural India, the more important being '(a) imparting of dynamism to agriculture which was previously stagnant; (b) the enlargement of the concept of agriculture to cover allied occupations like dairy, piggery, fishery, social forestry, etc., which are of special relevance for the economy of the weaker sections; (c) assured availability, on an increasing scale, of new agricultural technology including scientific utilisation of major and minor irrigation; (d) emerging shifts in national policies towards cottage, village and rural industries at localised production points; (e) increasing possibilities for absorption of institutional credit for effective implementation of productive projects; (f) growing importance of marketing, involving a series of extra-local transactions; (g) the emergence of growth centres and need for tackling the rural-urban continuum; (h) increasing emphasis on group action and conjoint activities; (i) growing concentration on special efforts to organise and assist the weaker farmers in particular and poorer sections of society in general; and finally (j) coupled with the developmental urges, the evolving need for provision of the welfare and municipal utilities requiring, in the rural areas, different types of technical servicing functions. ... The institutional, structural and functional contours of Panchayati Raj would thus have to be in conformity not only with the accelerating pace of development, but also with its strategies and policies' [Mehta, 1978, Pp. 176-177].

The Committee therefore recommended that 'the district should be the first point of decentralisation, under popular supervision, below the state level. .... Below the district level, the balance between technological requirements and possibilities for meaningful participation by the people in development management can .... be best achieved by grouping a number of villages to constitute Mandal Panchayats. These would not only ensure an economic viability but would enable the people's representatives to exercise democratic supervision over a large number of micro-projects which were to be implemented at the local level in the coming years. Most of these projects were not entirely village-based but would require a span of technology beyond the capacity of a Village Panchayat. The attention to the family-based programme, often covering as many as four hundred families', would 'need larger unit to tackle them' than 'at present. Such a Mandal Panchayat would cover a population of 15,000 to 20,000 and would also facilitate the forging of necessary linkages with schemes for development of focal points and growth centres and would ensure efficient management of growing rural-urban linkages' [Mehta, 1978, p. 178].

With the preference for a two-tier system of Panchayati Raj Institutions, namely, a district level Zila Parishad and a Mandal Panchayat covering a group of villages, the Committee recommended that the Block level Panchayat Samitis should be converted into non-statutory executive committee of Zila Parishads and when the Mandal Panchayats became active, most of the Samitis' functions would be taken up by the Mandal Panchayats. During the transitional period the Blocks could continue as per the convenience of the States. Similarly, at the village level the people could be involved in Mandal panchayats through Village Committees which could look after municipal functions and related welfare activities. The term of office of the elected members of the Zila Parishad and the Mandal Panchayats would be for four years; the composition of the two bodies as also the Village Committees was also suggested in the Report. The Committee was of the view that participation

of political parties in Panchayati Raj election would ensure clearer orientation towards development programme and facilitate healthier linkages with higher level political process. Direct elections coupled with programme-based contests, would offer great scope to weaker sections for availing of the opportunities offered by the political system.

The Committee felt that the Gram Sabha had an important role to play in activating the democratic process at the grass roots and deserved genuine encouragement. The Village Committees should 'have the special obligation to organise two Gram Sabha meetings every year to explain to the people what programmes the Mandal Panchayats are executing in their area and to channelise the people's feedback to the Mandal Panchayat' [Mehta, 1978, p. 181]. With regard to Nyaya Panchayats, the Committee was of the view that they should be kept as separate bodies and should not be mixed with the people elected for development panchayats. The members of development panchayats wielded executive powers and there were chances that justice might suffer if the two functions were combined. The Committee were in favour of a qualified judge to preside over a bench of separately elected Nyaya panchas. The elected Nyaya panchas would not be entitled to seek re-election; they should serve in an area other than that from which they had been elected. The Panchayati Raj elections should be conducted by the Chief Election Officer of the State in consultation with the Chief Election Commissioner [Mehta, 1978, p. 181].

The Committee recommended that all the development functions relating to a district, which were now being discharged by the State Government, should be placed under the Zila Parishads. Such decentralised functions could include agriculture and allied sectors, health, education, communications, rural industries, marketing welfare of backward classes, family welfare, etc. Functions such as agricultural research, college and university education, medium irrigation projects and other similar items involving complications or cutting across district boundaries may not be transferred to Zila

Parishads [Mehta, 1978, Pp. 182-183]. Cooperation should remain outside the purview of Panchayati Raj Institutions, while education must be entrusted to them. The functions of the Mandal Panchayats would include (a) responsibility for implementation of all schemes and projects assigned by the Zila Parishad, (b) a promotional role in actuating community action, build-up organisation and project formulation, (c) functions assigned to them under various statutes, and (d) municipal and welfare functions. There was need for purposive work allocation and transfer of money component along with the functions assigned to Mandal Panchayats for implementation. Mandal Panchayats should administer, coordinate and provide institutional supervision to on-going field level projects [Mehta, 1978, p. 184]. They should be suitably integrated with growth centres and be able to take the necessary decisions concerning marketing, input supplies, credit and servicing and welfare requirements in association with other organisations in this regard.

With the entrustment of a great deal of developmental functions at the district level, with the Mandal Panchayat playing a key implementational role, the Committee recommended a much larger devolution of funds to the Panchayati Raj bodies from the State budgets. When all functions relating to Plan implementation at district level are transferred to the Zila Parishad, this will also involve transfer of finance along with projects. Further, the non-plan expenditure incurred at the district or lower levels should also be under the administration of the respective tiers, since it would be conducive to composite development work and build up the capabilities of Panchayati Raj Institutions [Mehta, 1978, Pp. 195-196]. Apart from the budgetary devolution from the State Government, the Panchayati Raj Institutions also should mobilise enough resources of their own, as no democratic institution could continue to maintain its operational vitality by depending upon external resources. A select list of taxation powers should be given to the Panchayati Raj Institutions

and out of them some should be made compulsory. The taxation powers should be limited and specific and must not operate inequitously. In addition to taxes, the Panchayati Raj Institutions should levy fees/taxes for services like lighting, sanitation, water supply, etc. The maxima and minima of these fees should be laid down to avoid arbitrariness or lack of uniformity. Land revenue, cess on land revenue, cess on water rate, surcharge on stamp duty, entertainment tax and show tax, etc., should also be assigned to the Panchayati Raj Institutions, with higher percentage to Mandal Panchayats. The Committee recommended the complete transfer of land revenue to Panchayati Raj Institutions in a phased manner, over a period of five years taking into account the buoyancy of other taxes [Mehta, 1978, Pp. 193-195]. The Committee also recommended the transfer of public properties to be statutorily vested in the Mandal Panchayats. The custody of markets, fairs, etc., should also be vested with the Panchayati Raj Institutions in view of their being significant source of revenue.

In view of the transfer of substantial quantum of powers from the State Government to the local bodies and in order to achieve requisite status as well as continued functioning, the Committee recommended that some provisions in the Constitution deserved careful consideration of the Government of India [Mehta, 1978, p. 176]

The Report of the Committee on Panchayati Raj Institutions was discussed at the Chief Ministers' Conference held at Delhi on May 19-20, 1979. The Chief Ministers generally agreed to delegate more financial and administrative powers to the Panchayati Raj Institutions to make them effective instruments of development. The Conference decided to set up a Committee to frame guidelines for a model legislation for the purpose. While agreeing to strengthen the Panchayati Raj Institutions, the Chief Ministers did not accept the Committee on Panchayati Raj Institutions' specific recommendations regarding (a) the role of political parties in panchayat elections, (b) the structure of panchayat institutions, (c) the organisation and functions of Nyaya panchayats, and

(d) Constitution amendments for delegating more powers to the panchayats from the states [Financial Express, 1979].

#### *Sixth Five Year Plan, 1980-85*

Reviewing the working of panchayats in the country, the Sixth Plan envisaged strengthening of 'the process of democratic decentralisation. Irrespective of whatever structural pattern that is existent or that may be devised, effort will be to devolve on these institutions all such functions, appropriate to each level, which are capable of being planned and implemented at that level. These institutions will be particularly involved in the planning and execution of Integrated Rural Development Programme and the National Rural Employment Programme. They will also have prominent role in District and Block level planning and in the planning of Minimum Needs Programme for their area of operation' [Planning Commission, 1981, Vol. II, p. 176].

#### *Seventh Five Year Plan, 1985-90*

It was pointed out in the Seventh Plan, that 'although Panchayati Raj Institutions, in one form or another exist in most states, they have for a variety of reasons not been actively and effectively involved in the implementation of rural development programmes, except in a few states. On the other hand, it has been seen that wherever this has happened, the quality of programme implementation has been decidedly better. In terms of instruments of planning, Community Development and Panchayati Raj Institutions have been reduced to an extremely peripheral status with the budget provision in many cases being limited to maintenance of staff, while in other cases there is duplication and repetition of a large number of small schemes which are being simultaneously executed on a much larger scale through sectoral and special programmes, e.g., those relating to health, sanitation, road building, panchayat-ghars, etc.' [Planning Commission, 1985, Vol. II, p. 64].

'With the launching of large-scale, multi-sectoral, country-wide programmes of rural development (in the Seventh Plan period) aiming both at individual households and at the creation of assets in the rural areas, .....Panchayati Raj would have to break free from the conventional methodology of including a large number of small schemes through minimal budget provisions. What goes by the name of Community Development in the documents would have to be viewed now more in the nature of schemes for village development which would imply the planning and implementation of a number of residual activities at the village level which do not get covered in the normal sectoral plans and special programmes, e.g., village paths, drainage and sanitation. This in turn would have to be done on the basis of local, decentralised planning at the village and Block levels for which Block funds, both in the nature of outright and incentive grants would have to be placed at the disposal of Panchayati Raj and Community Development bodies rather than by forming sectoral plans for the villages at the State and National levels. ....In addition, the States would be called upon to activate Panchayati Raj Institutions, particularly at the village and Block levels, with a view to ensuring their active involvement in the planning and implementation of the special programmes of rural development, particularly those concerned with poverty alleviation and the provision of minimum needs' [Planning Commission, 1985, Vol. II, p. 64].

#### *Report of the Working Group on District Planning, May 1984*

In September, 1982, the Planning Commission set up a Working Group with Dr. C.H. Hanumantha Rao as Chairman to prepare guidelines for planning at the district level. The Group submitted its report in May 1984. The Group concluded that 'for decentralised planning to make headway, institutional mechanisms have to be made more broad-based with active involvement of local representatives and endowed with a greater degree of autonomy in local

decision-making. For this purpose, the Panchayati Raj Institutions and other local government institutions should play a crucial role in the district planning process. Ultimately, district planning will have to be taken over by these bodies. Therefore it would be necessary to strengthen them.... So that they could play their legitimate role in the district planning process in course of time' [Rao, 1984, Vol. I, p. 1].

The Working Group's experience had, however, revealed that 'democratic decentralisation had fallen a prey to power monopolisation by the rural elite' and had given rise to certain 'inner limits to public participation. Thus, the formal channels of participation through the Panchayati Raj Institutions with a view to adhering to democratic principles, has not guaranteed actual people's participation in the running of the affairs at the local level' [Rao, 1984, Vol. I, Pp. 83-84].

*Report of the Committee to Review the Existing Administrative Arrangements for Rural Development and Poverty Alleviation Programmes, December 1985*

The Planning Commission set up another Committee in March 1985 with Dr. G.V.K. Rao as chairman to '(1) review the existing organisational set up of on-going Rural Development and Poverty Alleviation Programmes and identify structural overlaps and constraints in the integrated delivery of services of different programmes; (2) suggest an appropriate administrative set up at the district level and below, which could provide an integrated framework for decentralised planning and implementation of these programming; (3) study the role of Panchayati Raj Bodies and their relationship with the proposed administrative set up, and to make appropriate recommendations in this regard...' [Rao, 1985, Pp. 81-82].

The Committee submitted its report in December 1985. The Panchayati Raj institution had been launched in 1956. According to the Committee, 'after the initial enthusiasm, following the creation of these institutions, there has been stagnation and later a decline in the functioning of these institutions in many parts of the country, while there are some notable

exceptions. Apart from inadequate resources, elections to these bodies have not been held regularly. In fact, elections have become overdue for one or more tiers of the Panchayati Raj Institutions in 11 States, and in 8 States even elections to Gram Panchayats are overdue. Elections have been put off on one pretext or another like drought, floods, census, general elections, delimitation, reservation, etc., and the terms of the existing bodies have been extended or the bodies have been superseded. The Sixth Plan objective of strengthening the process of democratic decentralisation, devolving on them such functions which are capable of being planned and implemented at the respective levels, and involving them in the planning and execution of Integrated Rural Development Programme, District and Block-level planning and the Minimum Needs Programme had only partial success. Wherever the Panchayati Raj bodies have been actively involved, the implementation of rural development programmes has been decidedly better and the selection of beneficiaries and designing of schemes have been more satisfactory' [Rao, 1985, Pp. 40-41].

The Committee felt that the 'States have been generally lukewarm to the process of democratic decentralisation. In most States, the Panchayati Raj bodies have been allowed to languish without powers and resources. Development has come of age and the time has come to take planning, decision-making and implementation process nearer to the people through democratic bodies. The inevitable need to transfer power of the State to democratic bodies at the local level has to be recognised. Inadequacies in the present system have to be remedied and a participative feeling in the gigantic task of rural development and poverty alleviation needs to be generated...'. The Committee was 'of the opinion that there should be a significant decentralisation at the District level. There should be a District-level body, say, the Zila Parishad for the rural areas, with directly elected members for every 30,000 to 40,000 population, with suitable scaling down for sparsely populated and hilly areas' [Rao, 1985, Pp. 44-45].

The Committee recommended that Panchayati Raj Institutions should be activated and given all support needed so that they could become

effective organisations for handling people's problems. Elections to these bodies should be held regularly. It re-emphasised the need for decentralised planning at the district level and below. Where Zila Parishads were in existence, rural development programmes should be transferred to them. This would ensure participation of local representatives in planning and they in turn would reflect the needs and aspirations of the local people. They would also be accountable to the people they represent. In States where Zila Parishads were not in existence, the setting up of District Development Councils with Government Officers as the Chief Executive Officer was suggested. In either case, it was envisaged that planning and implementation of sectoral activities would be decentralized and integrated into a unified activity, with horizontal coordination at the district level. Similarly, at the Block level too, an integrated area plan was imperative, based on availability of local skills and resources [Rao, 1985, Pp. 45-46].

'However, no uniform pattern was adopted across States. In 1989-90, the introduction of the Jawahar Rojgar Yojana, wherein it was stipulated that the funds would be placed at the disposal of the village panchayats marked a shift towards democratic decentralisation, with certain funds and powers vested in the gram panchayats for development' [Planning Commission, 1992, Vol. II, p. 34].

#### *Progress of Panchayati Raj Institutions during 1980-1990*

There was no uniformity in the working of the Panchayati Raj system in different parts of the country. The three-tier arrangement at the village, Block and district level was prevalent in 1990 in Andhra Pradesh, Arunachal Pradesh, Bihar, Gujarat, Himachal Pradesh, Karnataka, Madhya Pradesh, Maharashtra, Punjab, Rajasthan, Tamil Nadu, Uttar Pradesh, West Bengal and Chandigarh. The tier at the village level was generally called the village or gram panchayat, while the Panchayat Samiti was at the Block level and Zila Parishad at the district level. In Andhra Pradesh, with the passage of the Andhra Pradesh Act of

1986, the three tiers were at the village, mandal and district levels. The Karnataka Act of 1983 provided for panchayats at the mandal, taluka and district levels. In Gujarat, Maharashtra and Karnataka, the second or the middle tier was at Taluka level being coterminous with the Block level. In Tamil Nadu, the third tier was at *development district level* instead of *administrative district level* and was called District Development Council.

The two-tier system consisting of gram/naa panchayats at village level and Panchayat Samitis at the Block level was in existence in Assam, Haryana, Orissa and Manipur. In Assam, the two-tier system consisted of a naa panchayat at village level, and Mohkuma Parishad at the sub-divisional levels.

In Goa, Jammu and Kashmir, Kerala, Sikkim, Tripura, Andaman and Nicobar Islands, Dadra and Nagar Haveli, Daman and Diu, Delhi and Pondicherry, panchayats existed only at the village level. Meghalaya, Mizoram, Nagaland and Lakshadweep had their traditional councils of village elders.

Most of the panchayats at the village level were authorised to levy taxes. However, the items on which taxes could be levied varied among the different states (Table I). Government waste land was vested with the village panchayats in Andhra Pradesh, Kerala, Maharashtra, Orissa, Punjab, Tamil Nadu, Tripura and Delhi.

The tenure of the Panchayati Raj institutions ranged between three and five years. The panchayats were expected to be responsible for the promotion of agriculture, rural industries, provision of medical relief, maternity care, women and child welfare, maintaining common grazing grounds, village roads, tanks, wells, sanitation and execution of other socio-economic programmes. The gram panchayats were also involved in the identification of beneficiaries in anti-poverty programmes for the Integrated Rural Development Programme (IRDP) and the execution of the Jawahar Rojgar Yojana (JRY). By 1990, there were 2.20 lakh gram panchayats, 4.5 thousand Panchayat Samitis and 357 Zila Parishads in the country [Ministry of Information and Broadcasting, 1990, p. 452].

TABLE I. TAXES LEVIED BY VILLAGE PANCHAYATS

State	Name of Compulsory Taxation Items
(1)	(2)
Andhra Pradesh	House, Profession, Trade or Callings
Assam	Private Hat or Market places, Shops, Pharmacies, tailoring, laundry, hair cutting saloon, carpentry works, automobile workshop, supply of water, sale of firewood, thatch or bamboo, conservancy, lighting and slaughter houses, cultivable land lying fallow for two consecutive years without any valid reason, Minor irrigation water, Registration fee for cattle sold, fee on fishing. Licence fee on Tea Stall, hotel, restaurants, sweet-meat shops, collection of hives and bones, cart, carriages, cycles, boats, elephant, circus, professional variety shows, fairs, confectionary/bakery, private fishers weed for commercial purpose.
Goa	Building, vehicles, lighting, drainage, pilgrims, profession, trades, callings and employment, entertainment, dogs, advertisements other than published in the newspapers, octroi.
Gujarat	House, Pilgrim, Fair festival, vehicle, toll, pet dogs, trade, sanitary cess, market fee, cart stand fee.
Haryana	House, Profession, duty on transfer of property. Fees on Teh Bazari, service registration of animals, water rate, special tax on adult males of the panchayat for construction of public works of general utility.
Karnataka	Property, trade, building, lands which are not subject to agricultural assessment, vehicles, fairs, festivals and entertainment, fees on Bus Stands, Markets, supply of water from panchayat water works and cart stands.
Kerala	Building, Service, Profession, Vehicles, show entertainment, income from markets, licence fees, etc., duty on transfer of property.
Madhya Pradesh	Building, cleaning private latrines, lighting, profession, cart plying for hire, bicycles, rickshaws. Fee on registration of animals sold, market fees for the stalls, toll on vehicles and pack animals used for riding, driving draught or burden, or on dogs or pigs. Sarais, Dharamshalas, Rest House, slaughter house and encamping grounds, fee from persons practising the calling of buyers, broker, weighters, measures, water rate, drainage fees, sanitary cess, cart stand, grazing grounds, erections on public street or place.
Maharashtra	Lands, building and betterment levy.
Manipur	House, daily, biweekly or weekly markets, carriage carts, bicycles, rickshaws, boats and pack animals. Octroi or terminal tax, conservancy tax, water rate, lighting rate, fee on cattle ponds, fee for registration of animals sold, use of Dharamshalas, slaughter houses and grazing grounds vested in the panchayat.
Orissa	Vehicle, tolls, income from tanks, markets, fisheries, cattle ponds, village orchards; cart stand, slaughter house fee, licence fees, Ferry Ghats.
Punjab	House
Rajasthan	Building, pilgrim, vehicle except used in cultivation, on arranging the supply of drinking water, octroi on animals and goods, special tax on adult members for the construction for any public work.
Sikkim	On houses, fairs, melas, hats and other entertainment, fee for temporary erections, temporary occupation of private latrines, premises or compound cleaned by Gram Panchayat agency, grazing cattle on grazing lands vested in Gram Panchayat, use of Dharamshalas and encamping grounds, drainage where system of drainage is introduced by the Gram Panchayat and market fees.
Tamil Nadu	House, profession and vehicle.
Tripura	Lands, and buildings, transfer of immovable properties, entertainment and a duty in the shape of additional stamp duty on all properties.
Uttar Pradesh	On land revenue
West Bengal	On lands and buildings, on professions, trades and callings and employment, entertainments, registration fees for vehicles, additional stamp duty on transfer of immovable properties, water and lighting rates, conservancy rates, sanitary rates in fares.

Source: *Panchayati Raj at a Glance - Status of Panchayati Raj Institutions in India, 1988-89*, Ministry of Agriculture, Government of India, New Delhi, Pp. 2-4.

### *The Constitution (Seventy-Third Amendment) Act, 1992*

By the time the Seventh Plan (1985-90) ended it was felt that 'the objective of all round economic and social transformation of rural areas cannot be achieved without the active participation and involvement of people at the grass root level, both

in planning and implementation of the programmes of rural development' [Ministry of Rural Development, 1994, p. 2]. The Panchayati Raj Institutions were, at the same time, languishing without powers and resources. Government of India therefore introduced a comprehensive Bill in Parliament in 1992 to amend the Constitution for revitalising the Pan-

chayati Raj Institutions. The Constitution (Seventy-Third Amendment) Act, 1992 passed in April 1993, aimed at providing de-facto powers to Panchayati Raj Institutions and to ensure genuine decentralisation right up to the level of village panchayats. The Act provides for (a) the setting up of a Gram Sabha in each village exercising such powers and performing functions at the village level as the legislature of a state may provide by law; (b) panchayats to be set up in every state at the village, intermediate, and district levels; however, panchayats at the intermediate level need not be constituted in states having a population of less than two million; (c) all the seats in panchayats were to be filled by direct elections at all the three levels, although the mode of election of chairpersons was made indirect, or at the discretion of the state governments; (d) reservation of seats for Scheduled Castes,

Scheduled Tribes as well as for women; and (e) panchayats should continue for a term of five years, unless dissolved under any law for the time being in force. The Act further provided that the superintendence, direction and control of the preparation of electoral rolls for, and the conduct of, all elections to the panchayats should be vested in the State Election Commission consisting of a State Election Commissioner to be appointed by the Governor.

The panchayats were to be endowed with such powers and authority by the states to enable them to function as institutions of self-government, for the preparation of plans for economic development and social justice, and the implementation of such schemes, as entrusted to them including those provided in the Eleventh Schedule of the Constitution (Table 2).

TABLE 2. SCHEMES TO BE UNDERTAKEN BY PANCHAYATS UNDER THE ELEVENTH SCHEDULE (ARTICLE 243G) OF THE CONSTITUTION

1.	Agriculture, including agricultural extension.
2.	Land improvement, implementation of land reforms, land consolidation and soil conservation.
3.	Minor irrigation, water management and watershed development.
4.	Animal husbandry, dairying and poultry.
5.	Fisheries.
6.	Social forestry and farm forestry.
7.	Minor forest produce.
8.	Small scale industries, including food processing industries.
9.	Khadi, village and cottage industries.
10.	Rural housing.
11.	Drinking water.
12.	Fuel and fodder.
13.	Roads, culverts, bridges, ferries, waterways and other means of communication.
14.	Rural electrification, including distribution of electricity.
15.	Non-conventional energy sources.
16.	Poverty alleviation programme.
17.	Education, including primary and secondary schools.
18.	Technical training and vocational education.
19.	Adult and non-formal education.
20.	Libraries.
21.	Cultural activities.
22.	Markets and fairs.
23.	Health and sanitation, including hospitals, primary health centres and dispensaries.
24.	Family welfare.
25.	Women and child development.
26.	Social welfare, including welfare of the handicapped and mentally retarded.
27.	Welfare of the weaker sections, and in particular, of the Scheduled Castes and Scheduled Tribes.
28.	Public distribution system.
29.	Maintenance of community assets.

Extract from THE CONSTITUTION (SEVENTY-THIRD AMENDMENT) ACT, 1992 (Enacted on April 20, 1993).



The state legislatures have been given powers under the amendment Act to authorise the panchayats to levy, collect and appropriate suitable local taxes and also to provide for making grants-in-aid to the panchayats from the Consolidated Fund of the state. In addition, a Finance Commission has to be constituted by each state, once in every five years to review the financial position of the panchayats and to make suitable recommendations to the state on the distribution of the funds between the state and the local bodies.

'To give concrete shape to the provisions in the Amended Act, and have a uniformity in building up the institutions of Panchayati Raj, a conference of state ministers and secretaries in charge of panchayats was held in Delhi in July 1993. A Standing Committee of Ministers was constituted to ensure that adequate powers and resources were given to village panchayats for carrying out necessary developmental, regulatory and general administrative functions specially in regard to the 29 items, mentioned in the Eleventh Schedule of the Constitution' (Table 2) [Ministry of Rural Development, 1994, p. 2]. Government of India also set up a State Finance Commission Cell in the National Institute of Public Finance and Policy (NIPFP) to develop guidelines for state finance commissions and to undertake specific studies of different aspects of panchayat finances.

Parliament passed the Constitution (Seventy-fourth Amendment) Act, too in 1993, to provide for three types of Municipalities, namely, Nagar Panchayats for areas in transition from rural areas to urban areas, Municipal Councils for smaller urban areas and Municipal Corporations for larger urban areas. Two sub-clauses were added to Article 280 of the Constitution by the Seventy-third and Seventy-fourth Amendments, whereby it was made obligatory upon the Central Finance Commission to recommend 'the measures needed to augment the Consolidated Fund of a State to supplement the resources of the panchayats/municipalities in the State on the basis of the recommendations made by the Finance Commission of the State' [Pant, 1994, p. 46]. As most of the States were yet to reorganise the panchayats on the lines of the Seventy-third Amendment, enact legislation, and set up State

Finance Commissions, the Tenth Finance Commission had an onerous task before it, for devolution of funds to local bodies for the period 1995-2000.

The Tenth Finance Commission observed that 'In terms of the 73rd amendment to the Constitution, many of the functions of the State would have to be transferred to panchayats. It can be assumed that the transfer of functions and responsibilities from the State to panchayats would be accompanied by the transfer of staff already working on these schemes/projects as also the financial allocations budgeted for and envisaged to be spent on the transferred activities. Such a transfer is, therefore, not likely to result in any extra burden on the State. The States are still in the process of setting up panchayats and as such it is not yet feasible to work out the additional financial burden a State might have to bear to enable the panchayats to discharge their duties effectively. Even so, it is possible to visualise that the local bodies, raring to get on with their job once they are in position, would generate a need at least in the initial stages for augmentation of the consolidated fund of states. A few states have already reported that the number of panchayats may increase as a result of fresh delimitation exercises. Even taking into account the existing infrastructures and other facilities available to panchayats, there would still be an initial need for supplementation of resources in order to provide for not only the additional set up, including infrastructure facilities, but also the heightened expectations of people from these bodies' [Pant, 1994, p. 47].

The Tenth Finance Commission noted that 'a large amount of money is already going to the rural areas through Jawahar Rojgar Yojana (JRY) and other district level schemes. In future these amounts are likely to be channelised through the panchayats. Even if much of it is tied to specific programmes and activities, it would still leave some leeway for discretionary programmes to be taken up. The corpus of untied funds in the hands of panchayats would, however, require to be supplemented'. The Commission assumed that 'the need for measures to augment the State Consolidated Funds, on account of supplementation of the resources of panchayats, would not

really arise until 1996-97, since in most, cases the panchayats are yet to become functional' [Pant, 1994, Pp. 47-48].

The Commission therefore made an adhoc provision of Rs 100 per capita of rural population (Rs 1,095.23 crore) per year, commencing 1996-97. 'This amount should be distributed amongst the Panchayati Raj Institutions, over and above their due by way of their share of the assigned taxes, duties, tolls, fees, transferred activity related budgets and grants' [Pant, 1994, p. 48].

Thus after the initial years of enthusiasm, the Panchayati Raj Institution stagnated over a long period. Government's efforts at revitalising the institution commenced in the 1990s with the panchayats being involved in the numerous poverty alleviation programmes. Exceptions of continued performance of the institution were prevalent in West Bengal, Maharashtra and Gujarat and in later years in Karnataka, Andhra Pradesh and Kerala. In these states, the three tier system prevailed, elections were fairly regular and funds from state budgets devolved to the panchayats for implementation of development work.

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## **DOCUMENTATION**

The purpose of this section is to make available to the readers official documents such as reports of committees, commissions, working groups, task forces, etc., appointed by various ministries, departments, and agencies of central and state governments which are not readily accessible either because they are old, or because of the usual problems of acquiring governmental publications, or because they were printed but not published, or because they were not printed and remained in mimeographed form. It will be difficult and probably not worthwhile to publish the documents entirely. We shall publish only such parts of them as we think will interest our readers. The readers are requested to send their suggestions regarding official documents or parts thereof for inclusion in this section.

In the present section we publish:

Report of the Taxation Enquiry Commission, Vol. III, 1953-54, Chapters I to V, (Chairman: Sir John Mathai), Ministry of Finance, Government of India.

# REPORT OF THE TAXATION ENQUIRY COMMISSION VOL. III, 1953-54 - SALES TAX AND OTHER STATE TAXES

## CHAPTER I

### INTRODUCTION: SOME FEATURES OF THE SALES TAX

#### *Rate of sales tax*

We know it on the authority of those who have delved into these matters that the sales tax was not unfamiliar to the people of ancient India and that it occasionally played a sinister part in the history of medieval Europe. While of interest to the research scholar, this information can be of little comfort, in today's India, to the shopkeeper who has to pay the tax or the customer to whom he passes it on in turn. Indeed, few of our questions have evoked such enthusiastic assent as the one which seemed to suggest that the sales tax could perhaps be discarded from the tax system of the country; yet all we had done was to ask for comment on a proposition, not our own, that the sales tax served no purpose which could not equally be served by customs, excise and octroi. The State Governments did not share the zeal for abolishing the sales tax. They were clear about its distinctive role and emphatic that, in spite of its late arrival, it had come to stay in their budgets. No State had a sales tax before 1938. Today few are without it. Of a total revenue of about Rs 500 crore for all the States, the sales tax accounts for about Rs 57 crore. It is second in importance only to land revenue which yields about Rs 75 crore. In some of the States - Bombay, Madras and West Bengal for example - it is more important than even land revenue.

#### *Parties affected by the sales tax*

2. If few taxes raise so much revenue, few too have raised so many problems as the sales tax. This is not surprising. The sales tax impinges on a larger number of people and a larger number of interests than most other taxes. First of all, there is the consumer: the buyer of taxable goods. In this capacity, most people are affected including those whose income levels are well below that which attracts income-tax. Secondly, since it is from the seller that it is collected, the tax is of direct concern to numerous dealers of different sorts and sizes and habitats - wholesaler and retailer: large, medium and small: urban and rural - though the actual composition of the dealers

affected is of course different for different States. On industry too, that is to say, on manufacturers, processors and so forth, the sales tax has various repercussions. Finally, there are the State Governments; anxious to secure the optimum revenue from the tax, and confronted at the same time with large and growing evasion, these have to meet many difficulties of law and administration. Not least of the difficulties, and one which exists for trader and manufacturer no less than for the State Governments and the Central Government, is the problem of co-ordination between the different States. This, in turn, is related to the framework within which the Constitution has decreed that the sales tax laws of the States shall operate.

#### *Aspects of sales tax*

3. We may dwell a little on the manner in which the parties just mentioned enter the picture of sales tax; we may also instance briefly some of the more important aspects and problems which are present to the public mind. By and large, the revenue comes from the consumer. Sometimes he is painfully aware, and sometimes is left to be painfully curious, of what he pays as sales tax. The latter happens when the article has already borne the tax, perhaps at more than one of its successive sales, before he has had a chance of buying it. Occasionally, he demands to know whether all that is included as tax in the price he pays is in fact going to the coffers of the State: in other words, whether the dealer does not sometimes pocket the amount without passing it on to Government. There is also a different way in which the buyer enters the picture. This is when he evades the tax himself in concert with the dealer. While it is broadly true that, as the tax now operates, the burden of it is on the consumer, the task of complying with law and regulation falls to the lot of the dealer. A common problem is the complexity of the requirements placed on him. The small dealer, confronted with certain types of sales tax, finds these requirements particularly troublesome. Sometimes the dealer complains that the sales tax is driving him out of business. This is especially so when he is one of many links in the trade, the rate of the tax happens to be high, and the tax itself of a type which gets collected at every one of the links. For, in that

case, though this does not always happen, some of the links may tend to be dispensed with by those who buy. From the point of view of industry, the main problem arises from the need to produce and sell at competitive prices. To the extent that the rates vary much between different States - if raw material, for instance, is not taxed at all in one State, but is taxed high in another - this competition may be materially affected. Since the organised industries tend individually to be made up of different concerns specialising in different processes, the total might well turn out to be high of a tax that is collected at each of the stages. Also, many industries, especially the bigger ones, are interested in buyers all over India; their special grievance is the lack of an all-India uniformity in rates and regulation. The State Governments face a problem of evasion which is seemingly intractable. The interests of States often clash and co-ordination, as we have pointed out, has become difficult. This in turn has meant new hardships for trade and industry. Often the problems are such that the Central Government have to intervene but they have little power to do so effectively. Another difficulty arises from the ambiguities of the law and, not least, of the provisions of the Constitution; this of course is being resolved by the courts; but judicial decision takes time and, often enough, judicial interpretation replaces one set of difficulties by another.

#### *Suggestions regarding sales tax*

4. Some of these problems, especially those connected with inter-State trade, are such that it has occasionally been put forward as a solution that the sales tax should be removed from the purview of the States and placed in the Union List. Short of this somewhat drastic measure, various remedies are also suggested. For example, it is urged that all States should adopt a uniform multiple-point ('multi-point') tax; in disagreement with this view, but with equal confidence, it is held in other quarters that no problem would arise if only the single-point tax was adopted by all State Governments. As an improvement over the single-point tax is sometimes advocated what has come to be known as the double-point system; but there are other schools of thought which

regard that system as far too complicated. The extension of the 'selective' sales tax has also its supporters. In the context of all-India co-ordination has been canvassed the device of a purchase tax. It is claimed in its favour that it would not only bring about a solution of most of the difficulties, but would do so within the framework of the existing Constitution; when an article passes the boundary between two States, more than one Government are involved; but if State Governments, it is argued, will deal with their own traders who have purchased, and not with those of other States who have sold, the essentials of co-ordination will have been secured.

#### *Our approach to sales tax problems*

5. For a proper consideration of these and other suggestions, and of the problems which have occasioned them, we have to try and understand what the main features of the sales tax are in the forms in which it now operates in various parts of the country. A brief description of these aspects is attempted in the rest of this chapter. The next deals with the development of the sales tax: it seeks to describe and analyse the circumstances in which the sales tax has developed differently in different States. Partly connected with such development are the problems which have arisen in respect of the sales tax; some of these and the suggestions that have been made in respect of them are examined in Chapter III. The last two chapters of this section contain our conclusions and recommendations: Chapter IV is more specifically concerned with the Union and Chapter V with the States.

#### *Systems of sales tax*

6. We have incidentally mentioned some of the terms used in describing the different systems of sales tax which prevail in India. Thus there are the selective sales tax, the multi-point tax, the single-point tax and the double-point tax. Also, there is the purchase tax as distinguished from the sales tax. In regard to these terms and certain others which will have to be used in describing the features of the sales tax or in discussing the

specific problems connected with those features, a certain amount of clarification is necessary and it would be convenient to attempt it briefly at this stage before we proceed to a description of the features themselves.

*Distinction between sales tax and purchase tax*

7. We may first try to distinguish between a sales tax and a purchase tax, remembering that both may be levied by the States under the power given to them by the Constitution and that in either case it is only 'goods' that can be taxed and not, e.g. 'services' such as a lawyer or a doctor, or, at lower levels, a goldsmith or a barber, may render. The States' power to levy the sales and purchase taxes on goods is restricted in only one minor particular by the Constitution. The restriction relates to newspapers; only the Union can tax the sale or purchase of newspapers.

8. The sales and purchase taxes, then, with which we are concerned are taxes on the sales and purchases of goods. Obviously, we shall not have progressed much towards a real distinction by making the proposition that a sales tax is a tax on a sale, whereas a purchase tax is a tax on a purchase; for, a transaction which involves a sale by somebody must also involve a purchase by somebody else. In other words, sale and purchase are merely different ways of looking at the same transaction. But a proper distinction can be drawn between the two parties to it; one is the seller and the other the buyer. We may, therefore, say that the sales tax is a tax which with reference to the transaction of sale-cum-purchase, is levied on the seller, whereas the purchase tax is a tax which, with reference to the same transaction, is levied on the buyer. Now, an important element in the system of sale-cum-purchase taxation throughout the world is that the dealer may enter the picture as either seller or buyer, whereas the non-dealer enters only as a buyer. In other words, there is invariably a definition of 'dealer' (though this may be quite comprehensive and, as we shall see, may include municipalities and Governments), and no tax is levied on the sales of persons other than dealers. Taken in conjunction with this fact, the working definition we have adopted implies that there can, on the dealer, be either sales tax

(when he sells) or a purchase tax (when he buys in order to sell), while on the consumer who is non-dealer there can only be a purchase tax. It would be broadly correct to say of the nomenclature adopted in the sales tax systems of India that it adheres to this distinction between sales tax and purchase tax. When the tax is assessed on the turnover of the sales of a registered dealer, for example, and collected from that dealer, it is called a sales tax. If, on the other hand, it is assessed on the turnover of his purchases, and ignores whether he has sold what he has purchased, it is called purchase tax. The point of purchase, like the point of sale, may arise at different stages. Thus, raw material may be bought by a manufacturer; the manufacturer's goods may then be purchased by a concern engaged in the further processing of those goods; having passed this stage, the article may then be bought by a wholesaler; and the further purchases may be first by the retailer and from him by the consumer. A similar chain of transactions, both sale and purchase, can be envisaged when the article is imported from abroad instead of being manufactured in India. As the goods and finished articles pass from the preliminary to the final stages, the number of purchasers at each stage usually keeps getting larger and larger; and when we come to the consumer, i.e., the last purchaser, we have not only a very numerous body of persons, but also one which is indeterminate in the sense that it is very difficult to keep track of the persons and collect the tax from them. That is the reason why not only the sales tax but even the purchase tax tends to be levied on the dealer, including in that term the manufacturer and the processor, etc. There is, however, one exception to this. Where the article bought is conspicuous and more or less readily traceable - a motor car for example - the purchase tax may, if necessary, be collected from the private buyer. As we shall see later, such a necessity has arisen in certain contexts and accordingly we do have a variety of purchase tax which is levied on the private individual who buys an article for his own use. Apart from this, the purchase tax is confined to the dealer and to the types of transactions we have mentioned, viz., purchase of raw material by a manufacturer, purchase of finished goods by a

wholesaler and so on. Wherever it has been levied in preference to the sales tax or sometimes provided as an alternative to the sales tax - in the sense that Government levy either, but not both, at their choice - there have been specific reasons, usually administrative, for resorting to the purchase tax. Sometimes, as has been indicated, the purchase tax may be merely an additional safeguard if a dealer's records of sales are unsatisfactory, the account of his purchases may be looked into and a purchase-tax levied instead. In other contexts, the point of purchase may be inherently more convenient; thus a dealer in groundnut, who buys from farmers inside, and sells to manufacturers outside his State, can be taxed on his purchases; for it may be that the State Government find that his sales cannot be readily verified, because the buyers are not within the State; at the same time, the State Government are likely to find it most unsuitable to collect the same revenue in the form of a sales tax levied on the large number of cultivators who have sold to the groundnut dealer. It is necessary to keep some of these considerations in view as illustrating the distinction between the sales tax and the purchase tax. That distinction, as it has arisen in the actual administration of these taxes, is more than the formal or logical one that the sales tax is on the seller and the purchase tax on the buyer; it is in a very practical sense connected with a variety of administrative considerations arising in the process of levy and collection of the tax. It may be added that there are certain forms of sales tax which are very near in content to purchase tax but which should nevertheless be distinguished from the latter. Thus, sales tax, while levied on the sales, is sometimes related to the turnover of purchases; this happens when the account of purchases are normally maintained in sufficient detail, but not those of sales to the same extent, as in the case of small restaurants. In some States, a dealer of this kind is required to show the accounts of his purchases, and the turnover of sales is deduced from these accounts; the tax on them is not, therefore, purchase tax properly so called.

#### *General sales tax and selective sales tax*

9. We have used the word 'turnover' in the context of both sale and purchase. Sometimes the term 'turnover tax' is used to describe the sales tax in some of the States in India. This, however, has no specific significance, i.e., there are no special characteristics of a turnover tax which, with reference to the systems which have developed in India, serve to distinguish this from the sales tax on the one hand or the purchase tax on the other. In so far as a turnover tax implies that the tax is collected not on each sale but on the aggregate of sales, i.e., turnover, it is merely descriptive of a practice which, for convenience, State Governments have had to adopt in this country. But what is sometimes emphasised by the use of the word 'turnover tax' is that the sales tax concerned is of a 'general' type, i.e., the tax is collected on the sales of the generality of goods passing through a dealer and therefore on what may broadly be termed his turnover. The distinction here is between a tax on selected goods and one on the large majority of the goods sold by the dealer. This distinction, however, is best conveyed by another term which has come to be used, viz., the 'general sales tax'. Where, on the contrary, only selected goods are brought under the sales tax legislation of a State, we may describe the system as the 'selective sales tax'.

#### *Multi-point and single-point sales tax*

10. Omitting further reference at this stage to the purchase tax and the selective sales tax, both of which are in practice of restricted importance, we may now turn to a consideration of the general sales tax. This has two main varieties; the multi-point and the single-point. There is also the double-point tax, but this may be regarded as a sub-variety of the single-point system. An important distinction, in conception and design, between the multi-point system and the single-point system is that the latter seeks to ensure as far as possible that not more than a specific amount of tax gets added to the price at which the article is sold to the consumer; in other words, that the total tax charged in the passage of the article from the first dealer to the last in what may



be a whole chain of dealers is not left to be decided by the indeterminate number of links which may exist in the chain, but is collected at only one of the number of sales which may be involved. The double-point system is also designed to keep control over the total amount of tax which may have been added; but in it the tax may be collected at two points instead of one, i.e., on two different sales of two dealers through whom the article has passed to the consumer. The importance of restricting the total tax element to a predetermined amount, or approximately that amount, arises from the fact that the single-point tax and the double-point tax are usually levied at relatively high rates. As we shall see later, the same consideration also leads to a large number of exemptions - especially of essential articles like foodgrains and cheap cloth - in these systems. As broadly descriptive of both the single-point tax and the double-point tax, we may use the terms 'incidence-controlled' system, though of course the description would be more applicable to the fiscal design of the system than to the economic facts of its actual working.

11. The multi-point system differs from both single-point and double-point in that it is not incidence-controlled in either structure or purpose. The rate is relatively low and the exemptions few. The accounts which the dealer has to keep are less complex than under the other system. This follows from the fact that the incidence-controlled system is so designed as to take account, at every stage of whether the tax was paid at a previous stage or is going to be paid at a later stage. It is obviously a factor making for simplicity to tax each transaction by itself instead of troubling to provide for it as one of a series which it very often is. This will be clearer if we turn to the features of mechanism, including registration, associated with the single-point tax and the multi-point tax.

#### *Registration of dealers*

12. It is clear that a system of registration is necessary in either instance. The dealers from whom the tax is to be collected are numerous and widely spread. Administratively, it would be both costly and difficult to seek to collect the tax from

all dealers, big, medium and small, urban and rural. Hence the need for 'registering' those from whom the tax is to be collected.

#### *Significance of registration*

13. If it can be assumed that, of the kinds of articles on which the tax is proposed to be collected, all or practically all pass at one stage or another through a class of dealers defined in relation to their turnover of business, then it would suffice if the tax is collected from this class of dealers alone. These would be the registered dealers. Unregistered dealers would of course also sell, and often they would sell direct to the consumer, but on the assumption made in regard to the relevant kinds of articles, they would buy their requirements from one or more registered dealers and pay the tax as part of the price in the process of buying. On the other hand, they might buy from other unregistered dealers and sell direct to the consumers, but, again on the assumption made, the articles so bought and sold would be relatively unimportant and therefore deliberately left out of the purview of the system. If then the registered dealers are asked to keep accounts of what they have sold to other registered dealers, they can be exempted from the tax so far as these particular transactions are concerned; in other words, they would pay the tax on only such transactions as represent sales to unregistered dealers and consumers. This process of exempting a specific type of turnover, viz., that which is related to sales to other registered dealers, can be repeated all along the chain, so that ultimately only that registered dealer pays the tax who has sold the article to an unregistered dealer or a consumer. To put it differently, a sector of dealers (consisting of registered dealers) is defined and brought into being for the purpose of operating the tax and the tax is collected at only one point, viz., the point at which the article leaves this sector. The control of this point of exit for the purpose of tax levy is the essence of the single-point sales tax.

*A purchase tax at the point of entry*

14. But there is also the point of entry into the sector; this is the point at which the article is bought for the first time by a registered dealer from an unregistered dealer or from a person who is not a dealer at all. If, in a system of purchase tax, as distinguished from the sales tax, the tax is levied at this point of entry, we would have, instead of a single-point sales tax, a single-point purchase tax. In this instance, the extent of turnover would be the turnover of purchase and not the turnover of sale. In other words, every registered dealer would be exempt from tax on those transactions which he shows to be purchases from other registered dealers. The first registered dealer who has purchased pays the tax on the relevant turnover and no one else does at any point in the passage of the article to unregistered dealer or consumer.

*Double-point levy of sales tax*

15. Given a registered sector of dealers and the maintenance of the requisite accounts by every one within the sector, it will be seen that it is also possible to levy the tax not only at the point of exit or at the point of entry, but at both points. The essence of the double-point tax is a levy of this kind. The total tax which Government intend to levy on a particular article is split up between the two points; a specified amount is collected, at the point of entry, from the registered dealer who has first purchased the article, the tax itself being levied with reference to his subsequent sale of that article; and another specified amount is collected, at the point of exit from the sector, from another registered dealer, viz., the one who has last sold the article. This system too would be incidence-controlled, but with one minor qualification. The first tax, the one levied at the point of entry into the sector, would get added to the sale price at that stage; the second tax, therefore, would be assessed on a sale price which already included a sales tax and, to that extent, the tax element would be very slightly higher than the arithmetical sum of the two rates that have been charged at the two stages.

*Main features of a single-point sales tax*

16. It is clear that in an incidence-controlled system, whether single-point or double-point, an important requisite is that the class of dealer registered should be able to maintain the necessary accounts. Assuming that the turnover limit for registration has been so fixed as broadly to ensure this requirement, it may be expected that the dealer would also be able to keep separate accounts of sales of articles which are exempted from the tax altogether, even if such articles are fairly numerous. We have already said that, because of the relatively high rate which is characteristic of the incidence-controlled system, a number of articles, especially the more essential ones, are usually exempted under that system. This again is a feature which distinguishes the system from the multi-point tax.

*Main features of the multi-point sales tax*

17. In terms of comparison with the incidence-controlled system, the essence of the multi-point system is the absence of a defined sector with reference to which it is sought to be ensured that the tax borne is not dependent on the total number of times the article has changed hands within that sector. The dealers are of course registered, but each pays the tax irrespective of whether it is also collected from a preceding or succeeding dealer in the particular chain of transactions. This, as we have said, makes for relative simplicity of accounts; the same consideration is reflected in the fewer exemptions granted under the system, and another related feature is that the dealers who are registered are relatively more numerous than under the other system. In other words, the turnover limit for purpose of registration is much lower than for the single-point or the double-point. Last, but not least, the multi-point rate is substantially lower than that under the incidence-controlled system.

*Reasons for adopting multiple-point sales tax*

18. We have, for convenience of exposition, started with the features of the two systems and argued back to the class of dealers, coverage of

exemptions and rate of tax, but another, and in point of sequence more appropriate, way of explaining this relationship is to say that the multi-point system is occasioned by a decision of Government (1) to make the tax applicable to the majority of articles of consumption (including those which may be relatively essential); (2) to levy it on a large number of dealers (big, medium and small); and at the same time (3) to levy so low a rate that it is not a matter of serious consequence that the tax is paid several times over on the same article or that it is also levied on the essential articles. All the features of the multi-point system are then seen to be consistent with the intention and the design.

#### *Reasons for adopting single-point sales tax*

19. On the other hand, the single-point tax may be said to follow from a decision of the following nature on the part of Government: (1) to make the tax applicable to a large variety, but not the majority, of articles; (2) to levy it on a limited number of dealers, on the underlying assumption that the articles in question are such as will by and large pass, at one stage or another, through the limited but defined sector of tax-paying dealers; and (3) to pitch the tax at a relatively high rate, ensure that it does not have to be paid twice over and, further, since some of the articles sold by these dealers cannot well be taxed at that rate because of their importance to the less well-to-do consumer, provide for an adequately wide range of exemptions.

#### *Common features of sales tax system*

20. Having considered briefly some of the features which distinguish the sales tax from the purchase tax and the main varieties of the sales tax from one another, we may pass on to certain matters which are common to all these. Some of the items we have in mind are intimately connected with legal definition and interpretation, while some are inherent in the administration of the tax. We have, for example, used the terms of 'sale', 'goods' and 'dealer'; these may be

examined in more detail, as also the limit of turnover which constitutes for different classes of dealers the criterion on which registration is imposed as a legal obligation. Other topics to be considered are the rates of tax and the relation of these to different categories of articles; the total exemptions from the tax as these arise in various degrees and for different reasons; and, finally, certain aspects of assessment, collection and appeal, and of administration generally. In many of these features, as we have already indicated, there is considerable difference between the systems of different States. For a State-wise account of the main features, reference is invited to Appendix A (not printed here). No description of the systems of individual States will be given in the following paragraphs, except for illustrative purposes.

#### *Meaning of 'sale'*

21. The layman who asks: "What is a sale?" would not have to go without an answer; he would find plenty of replies in the reported judgements of courts of law; and he would not be a layman if, piecing them together, he was able to say when, where and how a sale becomes a sale which a sales tax may tax. Unable to avoid some reference to this highly technical matter, we propose to pursue the path of caution by leaving the position to be explained by extracts from authoritative judgements. The two we select have the virtue of being lucid. One is from a judgement of the Madras High Court\*. The other and much shorter extract is from a judgement of the Supreme Court of India\*\*. Either judgement of course like the judgements of all courts, is concerned not with expounding the subject as a whole, but only with those aspects of it which are relevant for a decision on the matter specifically before the Court.

22. The Madras High Court says: "The word 'sale' has both a legal and a popular sense. In the legal sense, it imports passing of property in the goods. In its popular sense, it signifies the

\*Popatlal Shah vs. State of Madras, August, 1952.

\*\*State of Travancore-Cochin and Ors. vs. The Bombay Co. Ltd., Alleppy and Ors., October 1952.

transaction which results in the passing of property.... If one leaves out of account sales tax legislation which is of comparatively recent origin, questions relating to sale of goods usually come to courts only in connection with disputes between sellers and purchasers.... For deciding these and similar questions, it is necessary to determine at what point of time the property in goods passed to the purchaser. Sometimes when the point for determination is as to jurisdiction of court to entertain suits based on contract, it may be material to consider where property in the goods passed, that being part of the cause of action. These being the questions which are accustomed to be debated in connection with the sale of goods, it is natural that a lawyer should, as a matter of first impression, approach the question of sale under the Sales Tax Act with the same concept of a sale. But if the matter is further considered, it will be seen that considerations which arise under the Sales Tax Act are altogether different from those which arise under the Sale of Goods Act. The object of the Sales Tax Act is to impose a tax on all sales and it is a tax imposed on the occasion of sale.... So far as the Government is concerned, it will be immaterial at what point of time property in the goods actually passed from the seller to the buyer. Of course, there must be a completed sale only when property passes.... But when once there is a completed sale, the question when property passed in the goods would be a matter of no concern or consequence for the purposes of the Sales Tax Act. The Government is interested only in collecting tax due in respect of the sale and the only fact which it has to satisfy itself is whether the sale took place within the Province of Madras. In this sense the popular meaning of the word is the more natural one, and there is good reason for accepting it."

23. We cite the following observations of the Supreme Court merely to emphasise the point that much judicial ground has apparently yet to be covered before we shall know all the implications of sale for the purposes of the sales tax:-

"In the foregoing discussion, we have assumed that the word 'sale' used in the Constitution has the same meaning as in the law relating to the Sale of Goods, but it has been

suggested in the course of the argument that it imports a wider concept than the passing of title from the seller to the buyer which, under that law, is determined by highly technical rules based upon the presumed intention of the parties and liable to be displaced by their expressed intention. We leave the point open as it is unnecessary for the purpose of these appeals to pronounce any opinion upon it."

24. The actual meaning attached to the word 'sale' in the Acts of different States may now be illustrated. In Madras, Mysore, Travancore-Cochin and Hyderabad, sale means transfer of property in the course of trade or business. By implication, all other sales are excluded. Casual sales by individuals, sales of food by hostels attached to educational institutions, sales of old furniture, for example, by firms not dealing in furniture and so on are, therefore, not liable for the tax in these States. The States of Bengal and Delhi define sale as transfer of property in goods for money consideration, which accordingly excludes transfers for other consideration like exchange or barter. According to the Acts of certain States, the sale is deemed to have taken place in the territory of the State, if at the time when the contract of sale or purchase was made, the goods were actually in those States. In certain States the transfer of property in goods supplied in the execution of a contract is also included in the definition of sale.

#### *Definition of 'goods'*

25. The term 'goods' has usually been defined to include only movable property other than actionable claims, stocks, shares and securities. In some States, the term includes growing crops, grass, trees and other objects which are attached to the earth, but are to be separated from it under the terms of the contract.

#### *Definition of 'dealer'*

26. A 'dealer' is defined in most Acts as a person who carries on the business of selling or supplying goods in the State concerned. A co-operative society or a club or an association which sells

goods to its members is also treated as a dealer. Under some of the Acts, a municipality or a State Government carrying on the business of selling or supplying goods comes within the definition of dealer; in certain others, both the State and Central Governments are excluded. The legislation of certain States purports to include within the term dealer all persons of that category, irrespective of their residing in other States, provided only they sell or supply goods to persons resident in the territory of the State concerned. A more restrictive provision appears in the Acts of other States; thus, it is the resident agent or manager of a non-resident dealer, and not the non-resident dealer himself, that comes within the purview of the term dealer as defined in these Acts.

*Turnover- its meaning and limits thereof for tax liability*

27. The liability of a dealer is fixed on his 'turnover' or the aggregate amount of the sale prices of his goods. Sale price is the amount of value or consideration payable to a dealer for the sale of any goods, including any sum charged for anything done by the dealer in respect of those goods at the time of or before that sale. It, however, excludes the amount of discount allowed as a matter of trade practice; it also excludes the cost of freight or delivery and the cost of installation, when such costs are separately shown. Different limits of actual turnover are laid down in different States for fixing the liability of dealers to pay the sales tax. Usually, there are two distinct limits, one for importers and manufacturers and the other for all other dealers. A relatively low limit of turnover for registration of importers and manufacturers has been found necessary in actual practice. The points of manufacture in the particular State, as well as of import into the State either from abroad or from other States, are obviously of strategic importance in that it is from these points that the trade channels of that State commence and broaden out in their flow to the ultimate consumer. Hence the importance of ensuring that too many points are not left out at the stages of import and manufacture. Thus, unless the limit for registration was

adequately low, the unregistered - and therefore non-taxpaying - importer would tend to spring up in larger numbers to the detriment of the registered importer as well as of the revenues of the State. Small manufacturers can, of course, be ignored if the goods they produce happen to be non-taxable, i.e., 'exempted', but where a large number of small manufacturers together account for a significant proportion of some taxable variety of goods, it is of obvious importance that, along with the bigger manufacturers of the same kind of goods, they too should be brought within the system of registration. It is for reasons such as these that the limit for importers and manufacturers is nowhere more than Rs 10,000; it is Rs 5,000 in certain States (e.g. Madhya Pradesh and Madhya Bharat). The limit for other categories of dealers varies very considerably. Thus, it is Rs 7,500 in Assam and Hyderabad; Rs 10,000 in Madras, Mysore, Orissa and Travancore-Cochin; Rs 15,000 in Uttar Pradesh and Bihar; Rs 25,000 in Bombay and Madhya Pradesh; and Rs 50,000 in Bengal and Punjab.

*Sales not liable to tax*

28. Certain sales, then, are excluded from the purview of the tax in different States, not merely because of the definition adopted of 'sale', but as a result of other specific provisions in the Acts. Before passing on to the category of exemptions, we may enumerate the categories of sales thus excluded:

- (1) sales not in the course of trade or business;
- (2) sales for other than money as consideration;
- (3) sales of immovable property;
- (4) sales of actionable claims, stocks, shares or securities;
- (5) sale of agricultural produce grown by the cultivator himself or on land owned by him; and
- (6) sales by dealers whose annual turnover is below the taxable quantum.

Many of these exclusions are dictated by administrative considerations. For example, sales by agriculturists and sales by dealers with low turnovers are excluded for the reason that it would be both difficult and costly to collect the tax from them, besides involving harassment to a large number of small people.

### Exemptions

29. Specific exemptions are granted from the levies of sales tax either under Schedules to the Acts or by Government notification. The exemptions may be regarded as of four categories; (i) certain goods which are treated as 'essential' for various reasons (including goods which enter substantially into the cost of living of the working class, the lower middle class, etc.); (ii) goods which are already taxed appreciably under other laws; (iii) products of certain cottage and village industries; and (iv) other goods. To the first category belong the exemptions granted in respect of one or more of the following in various States: foodgrains, milk, fresh vegetables, fresh fruits, salt, *gur*, edible oils and oilseeds, kerosene, matches and cheap cloth. The second category includes petrol, electricity, tobacco, etc., in the particular instances in which it happens that these are liable to other and substantial levies of the State Government. Thus, electricity duty and selective sales tax on petrol imposed by separate enactment are both specifically excluded from general sales tax. Exemptions of khaddar, handloom cloth, hand-made paper, *ghani* oil, hides and skins, cotton yarn, etc., are granted as part of the encouragement accorded by different State Governments to cottage and village industries. The other miscellaneous exemptions include articles like text-books, sacred books, agricultural implements worked by hand, cattle foods, fertilisers, manure, certain medicines, etc. The list of exemptions varies from State to State. As already pointed out, it is larger in the single-point States than in the multi-point ones. Madras has the shortest list, the only articles exempted being salt, handloom yarn and khaddar; while Saurashtra has the longest, comprising more than 60 articles. Besides sales of goods, sales to or by certain institutions, associations or Government Departments are exempted in different States. These sometimes include sales to co-operative and other institutions producing or marketing cottage industry products, sales by the canteen stores of the Defence Department, etc. Apart from these outright exemptions, there are instances of articles on which lower or concessional duties are charged. For example, in Madras, by way of

exception to its multi-point levy, cotton yarn is taxed at only one stage of sale at half per cent, bullion and specie at one stage at quarter per cent, and hides and skins and cotton at one stage at the ordinary rate. Vegetables, fruits, flowers, fish and meat are taxed at slab rates up to turnovers not exceeding Rs 20,000. Mysore and Travancore-Cochin have more or less similar concessional rates for these and a few more goods. Uttar Pradesh exempts the sales of raw hides and skins, hukkah tobacco, shellac and sann hemp on payment of fees at the rate of four annas per Rs 100 subject to a maximum of Rs 1,000 and levies the tax at only one point (sale by importer or manufacturer) on edible and non-edible oils and on tanned leather. In Hyderabad, fruits, books and cotton yarn are taxed at only one stage, i.e., first sale in the State.

30. So far as the single-point States are concerned, Orissa levies a tax of only quarter of an anna on sales of matches and cotton yarn against the general rate of three-quarters of an anna per rupee. Bihar levies a three-pies tax on edible oilseeds and oils, cotton cloth, all cereals and pulses, bread, flour, bullion and specie, while the general rate is six pies per rupee. In Madhya Pradesh, vegetable oils are charged at a lower rate while in Saurashtra bullion and specie are subject to a tax of quarter per cent. In Bombay, cotton, oilseeds, art silk yarn, woollen yarn, hides and skins, are charged only to the last point tax at a lower rate (one per cent) for cotton and three pies per rupee for others (against the general rate of six pies), while bullion and specie are charged at quarter per cent at the first point and quarter per cent at the last point. As already stated, exemptions are fewer in multi-point States; even foodgrains are not exempt in certain instances. The general argument advanced in support of this policy is that so far as the rural population are concerned, they, in many instances, consume their own produce and, to that extent, their cost of living is not unduly affected by the levy of tax on essential commodities; it is added that it becomes necessary to tax certain exportable articles and raw materials at concessional rates in order to ensure that the competitive capacity of the trade and industry of a State is not unduly handicapped. The high rate of tax in a single-point

system necessitates, as we have said, a larger number of exemptions in order that trade, industry and the poorer classes of consumers are not burdened with too heavy an incidence. Most of the essential commodities and raw materials are, as a rule, completely exempted under a single-point tax, in a few States, a lower rate is imposed on such articles.

#### *Higher tax on 'luxury goods'*

31. Just as certain essential commodities and raw materials are either exempted completely or taxed at a lower rate, there are certain types of goods, generally consumed by the relatively well-to-do classes, on which higher rates of taxes are levied in a number of States. These goods are sometimes called 'luxury goods', though not all of them can be properly deemed to be articles of luxury. The schedule of these special goods differs from State to State. The articles common to most schedules are:-

- (i) motor vehicles and their accessories;
- (ii) refrigerators and air conditioning plants;
- (iii) wireless reception sets, radios, gramophones, etc.;
- (iv) cinematographic, photographic and other cameras and accessories;
- (v) electrical goods, instruments, etc.;
- (vi) fountain pens, pencils of costly types;
- (vii) clocks, time-pieces, watches and parts thereof;
- (viii) upholstered furniture, iron and steel safes, almirahs and furniture;
- (ix) arms and ammunitions; and
- (x) perfumery, cosmetics, vanity bags, furs.

Bombay has the largest list of such articles, while Madras has the smallest. The rates of tax vary from nine pies to twenty-four pies. In the multi-point States, the higher rate is levied at the first stage of sales in addition to the ordinary rate of tax, while in the single-point States, the tax itself is collected at a higher rate and as an additional levy.

#### *Submission of returns and payment of tax*

32. Every registered dealer is liable to the sales tax. The payment of tax is, however, limited to

the amount of tax on his turnover of goods in respect of sales which do not fall within the scope of the exemptions and exclusions. Therefore, while submitting returns of his turnover, the dealer computes the tax payable by him by deducting from his gross turnover, the turnover in respect of exempted and excluded sales. This amount has to be paid into a Government treasury and the receipt sent along with the return of turnover. These returns have to be submitted periodically, every quarter in most States, half-yearly in some and monthly in a few. It is open to the dealer, if he discovers any error or omission in the return submitted by him, to inform the Sales Tax Authorities and submit a revised return.

#### *Procedure regarding assessment*

33. The year of assessment is usually the financial year, though in some States it is the accounting year according to the trade practice observed by the dealers concerned. Normally, the assessment is made for the whole year. Shorter periods of assessments are, however, prescribed in a few States for classes of dealers who it is thought are likely to evade the tax. Where the Sales Tax Authorities are satisfied about the correctness and completeness of the returns furnished by the dealer, the assessment is made on the basis of the returns. Where the returns have not been furnished or where the Sales Tax Officer is not satisfied with the correctness of the return that has been furnished, he can assess the dealers, after issuing due notices to them, to the best of his judgement. A similar procedure is adopted in respect of dealers who have wilfully avoided registration and failed to submit returns. In such assessments, the Sales Tax Officer calls for books of accounts and other documents to help him in making an assessment as nearly conforming to facts as possible. But if the books of accounts are not maintained, or are maintained incompletely or fraudulently, the Officer has no other alternative but to assess the tax payable on the basis of such evidence as is available to him, e.g., previous assessments, the dealer's status, his reputed financial circumstances, sales made to him by other dealers, etc. The same procedure is followed with respect to dealers who are liable to the

tax but have evaded registration and, consequently, the submission of returns. Where this occurs, penalties are imposed in addition to the assessment made according to the best of the Sales Tax Officer's judgement. The difference between the tax paid by the dealer and the tax assessed by the Sales Tax Officer is thereafter adjusted. Where additional tax is recoverable, notice is sent to the dealer to pay the amount within a prescribed period. If the dealer has paid more tax than was due, a refund is granted or the excess is permitted to be adjusted against future payments. In regard to the inspection of the dealer's books, the Sales Tax Officers have, in most States, powers of entering into and searching the premises of the dealers, their godowns, etc., and also the power to seize and detain books of accounts, documents, goods, etc., relevant to their enquiry. Similarly, the Sales Tax Authorities have the power to re-open assessments, if fresh information involving suppression of sales, fraudulent practices, under-estimation, etc., becomes available to them. For dealing with the assessment of small traders who find it difficult to maintain elaborate accounts, several States provide a scheme of composition under which the amount of the tax is determined on the basis of taxable purchases; a specified percentage is added to these as assumed margin of profit, and the resultant figure is treated as the turnover of taxable sales.

#### *Appeals and revisions*

34. Against the assessment orders (or in some States, against any order of the Assessing Authority), the dealers have the right to appeal to, or of seeking revision by, the higher authorities. In some States, semi-judicial institutions like Appellate Tribunals consisting of independent and experienced persons, are established to hear final appeals. In others, either the Boards of Revenue or authorities like the Financial Commissioners are the final appellate authority. A reference can be made either by the dealers concerned or by the Assessing Authority to the High Court on any point of law arising from the orders of the revising or appellate authorities. The appeals or applications for revision have to be

made within the prescribed time and have to be accompanied by satisfactory proofs of having paid the amount of taxes as assessed (or, in some States, the amount admitted by the dealer himself or a certain percentage of the tax assessed, whichever is greater). Powers of revision of orders of assessment, review and rectification of mistakes are given to the Sales Tax Authorities in most States. Whatever information comes into the possession of the Sales Tax Authorities in the course of assessment of any dealer is to be treated as confidential and cannot be disclosed except for purposes of criminal prosecution or for being supplied to the Income-tax Authorities, or to other Sales Tax Authorities, in furtherance of proper collection of taxes.

#### *Offences under the sales tax laws*

35. The principal offences under the different State Sales Tax laws are -

- (i) carrying on business without being registered (or without being licensed where licence is necessary);
- (ii) not furnishing returns within the prescribed time, or wilfully furnishing wrong and false returns;
- (iii) not paying the tax when due;
- (iv) falsely representing oneself as a registered (or licensed) dealer;
- (v) knowingly producing incorrect accounts, documents, etc., or furnishing incorrect information;
- (vi) obstructing an officer in making inspection, search or seizure;
- (vii) aiding or abetting any person in the commission of any of the above offences.

These offences are punishable with fine and in some States with imprisonment. Most of the States however provide for composition of these offences by payment of prescribed amounts.

#### *Administration of sales tax*

36. The administration of the sales tax is in most States in the hands of a department separately constituted for that purpose. Sometimes, only the main function of the department is related to sales



tax and it is entrusted in addition with the collection also of taxes like agricultural income-tax, entertainment tax, tax on motor spirit, etc. Below the Head of the Department who is called Commissioner or Collector of Sales Tax, Commissioner of Commercial Taxes, etc., there are Deputy or Assistant Commissioners, etc., and Sales Tax (or Commercial Tax) Officers. In most States, the assessment is done by officers of gazetted or senior rank, while in a few States it is entrusted to subordinate and non-gazetted executive staff. The assessing authorities are kept distinct from the appellate authorities in most States; in some, however, the two functions are combined at the higher levels. In a few States, e.g., in Bombay and Saurashtra, there are Advisory Committees consisting of representatives of trade and industry who serve to effect as a liaison between the administration and the tax-payers by bringing to the notice of the former grievances

and hardships of a general nature.

#### *Importance of sales tax as a source of revenue*

37. We may conclude these observations on the features of the sales tax and its administration by drawing attention again to an aspect which we mentioned at the outset, viz., the importance of the tax as a source of revenue for the States. All Part A States now levy the tax; so do all Part B States with the exception of Rajasthan which, however, has recently passed legislation to introduce the tax; and among Part C States, Delhi, Vindhya Pradesh and Manipur already levy the tax. Taking all the States together, the total revenue from the sales tax estimated for the budgets of 1954-55 is over Rs 57 crore. The figures for individual States are given below:-

TABLE 1. RECEIPTS FROM SALES TAX

	(in crores of Rupees) 1954-55 (Budget Estimates)
<b>Part A States</b>	
Andhra	3.15
Assam	0.72
Bihar	2.72
Bombay	16.61
Madhya Pradesh	1.95
Madras	9.50
Orissa	1.30
Punjab	2.14
Uttar Pradesh	5.25
West Bengal	4.60
<b>Total for Part A States</b>	<b>47.94</b>
<b>Part B States</b>	
Hyderabad	2.00
Madhya Bharat	1.40
Mysore	1.57
PEPSU	0.47
Saurashtra	0.70
Travancore-Cochin	2.05
<b>Total for Part B States</b>	<b>8.19</b>
<b>Part C States</b>	
Delhi	1.12
Vindhya Pradesh	0.18
Manipur	0.02
<b>Total for Part C States</b>	<b>1.32</b>
<b>Total for all States</b>	<b>57.45</b>

## CHAPTER II

## THE DEVELOPMENT OF THE SALES TAX

We have considered briefly some of the main features of the sales tax as it operates in different States in India. Why is it that the tax is not uniform, and that in design, no less than in detail, there is so much difference from State to State? Part of the explanation may be found in the fact that many of the States are newcomers to this field of taxation still engaged in experimentation on different kinds of sales tax to suit different conditions. The chronology of development is not without significance, especially if we remember that the existence of an older system, already tried in an important State like Madras or Bengal, offers strong inducement to a neighbouring State to copy that system.

*Chronology of the sales tax levy in India*

2. The first sales tax to be levied in India was a selective sales tax. It was introduced in 1938 in Madhya Pradesh in the form of 'petrol tax', i.e., a tax on the retail sales of motor spirit and lubricants. The petrol tax, often governed by a separate enactment and therefore distinct from legislation pertaining to the general sales tax, has since been introduced by various States. The General Sales Tax itself dates from 1939 when Madras introduced the multi-point system. Next came Bengal which adopted a single-point system in 1941. The Punjab Act of 1941 was broadly based on the multi-point model, while the Bihar tax of 1944 followed the single-point system of Bengal. The next relevant period is 1946-48. Five other States adopted the tax before 1st April 1948. Four of these, viz., Bombay, Assam, Madhya Pradesh and Orissa adopted the single-point system; the fifth was Uttar Pradesh which adopted the features of the multi-point tax, but with significant modifications. Since April 1948, have come in most of the remaining States, including almost all the Part B States. Of these, some adopted the multi-point system of Madras (Mysore, Travancore-Cochin and Hyderabad) and the rest a single-point tax either on a large variety of articles or sometimes on so few as to make the tax indistinguishable from a selective sales tax (PEPSU, Madhya Bharat and Saurashtra). The

models originally introduced have undergone substantial modifications or sometimes have been replaced by altogether different structures. Punjab, which changed over from multi-point to single-point, and Bombay which proceeded from single-point to multi-point and then to double-point are notable examples. Moreover, purchase taxes have been introduced to a limited extent in different States. The exemption lists, as we have seen, vary widely and so do the levies of turnover at which dealers are licensed or registered.

*Operation of the tax in certain illustrative States*

3. All this cannot be explained in terms of mere chronology and contiguity. Obviously, there are other considerations which underlie the fact that Madras, for example, has a multi-point system whereas Bengal has a single-point one. Before attempting to analyse the main factors responsible for the development of different systems in India, it would be convenient to examine two specific aspects in a little more detail; firstly, the main features of the tax as it has operated at different periods in a few typical States and secondly, the measures for all-India co-ordination, administrative and other, which have been taken from time to time, including those which are embodied in the Constitution in the shape of restrictions on the powers of the States.

4. The six States we may consider in some detail for purposes of illustration are Madras, Bengal, Bihar, Bombay, Uttar Pradesh and Madhya Bharat.

*Madras* - The relatively simple multi-point tax which was introduced in Madras in 1939 has now grown into a complex system. Initially, the tax was levied at the rate of five rupees per month on turnovers between Rs 10,000 to Rs 20,000 a year and at 1/2 per cent on turnovers exceeding Rs 20,000 a year. In 1940, the rate of tax was reduced to four rupees per month and 1/4 per cent, respectively. The rates were changed in 1943, the tax was increased to eight rupees per month on turnovers between Rs 10,000 and Rs 15,000, twelve rupees per month on turnovers between Rs 15,000 and Rs 20,000 and one per cent on turnovers exceeding Rs 20,000 a year. Since January 1948, the slab rates of taxes have been abolished,

the general rate of tax has been increased to three pies per rupee and an additional tax at one stage of sale at three pies or six pies per rupee on certain luxury articles like motor vehicles, radio sets, electrical goods, photographic cameras has been introduced. The absolute exemption previously enjoyed by bullion and specie, cotton yarn and handloom cloth has been withdrawn. Bullion and specie are now chargeable to tax at 1/4 per cent only on the sale by the first dealer in the State; cotton yarn other than handspun yarn is also taxed at 1/2 per cent at only one stage, khadi is exempt when sold by persons dealing exclusively in it while handloom cloth of mill yarn is liable for tax at only one point. Taxation of 'works contracts' on the proportionate cost of the goods involved in such contracts was also introduced about the same time. From August 1949, on articles of food and drink sold in hotels with turnovers exceeding Rs 20,000 a year, the rate of tax was increased from three pies to four and a half pies per rupee. Sales of cotton which had previously been exempt were made liable to a tax of 1/2 per cent at a single point. Some of these measures were necessitated partly by the need to make up the loss of revenue occasioned by Prohibition and partly by the necessity of meeting the increased expenditure on development schemes. For encouraging the handloom industry, the tax on handloom-woven cloth was reduced, in 1951, from three pies to one and a half pies per rupee. The State Government have recently passed a Bill imposing a tax at the rate of fifteen pies per rupee at one point in addition to the multi-point tax on all mill made cloth (including woollen and silk fabrics but excluding coarse cotton cloth of 16 counts and less), and exempting handloom cloth completely from the sales tax.

**Bengal** - In 1941, when the sales tax was introduced for the first time, the rate was three pies per rupee. The taxable quantum was Rs 10,000 a year for importers and manufacturers and Rs 50,000 for others, with provision for voluntary registration for dealers having a turnover more than Rs 10,000 a year. The rate of tax was increased to six pies in 1944 and to nine pies per rupee on 25th June, 1945. There has been no change since then. Other amendments to the Sales Tax Act have been made more with a view to

checking evasion, e.g., in 1949, liability to pay tax was brought forward from three months after the end of the year in which the dealer's turnover first exceeded the taxable quantum, to a date two months following the day within the year on which his turnover exceeded the taxable quantum. The exemption in favour of handloom cloth sold by dealers dealing exclusively in them was replaced by the exemption of *dhotees*, *sarees* and *lungis*, both mill-made and handloom-woven, sold at prices not exceeding the notified maximum price limits. In 1949, the exemption list was curtailed by withdrawing from it articles like mustard and rape oil and oilseeds, matches, fresh fruits, coal and coke, coal gas, charcoal, fuel wood, hides and skins and handmade paper; an additional revenue of about Rs 50 lakh was expected in consequence; but on the more important of these items, the exemption was restored almost immediately. Recently, as a measure of anti-evasion, the Bengal Government has imposed a tax at the rate of three per cent on sales of cigarettes by importers and manufacturers.

**Bihar** - The rate of tax when the Bihar Sales Tax Act was enacted in 1944, was three pies in the rupee, though there was provision in the Act to increase the rate of six pies per rupee, or levy a lower rate, on specified goods by means of a notification. The Act more or less followed the Bengal Act in regard to exemptions, procedure and the system of tax. It was repealed by the Bihar Sales Tax Act of 1947 under which the rate of tax continued to be three pies. A reduced rate of one and half pies per rupee was levied on tobacco despatched outside the State and articles like *gur*, potato, mustard seed and oil, rape seeds and oil, fertilisers, matches, text-books and coal-gas which were tax-free hitherto, were made liable to tax. Despatches of taxable goods by or on behalf of a dealer to outside Bihar were made taxable with effect from 1st July 1947. Bihar was the first single-point State to levy a tax on such exports. In 1948, the rate of the tax was first increased to six pies per rupee on luxury articles like motor vehicles, cigarettes, cheroots, upholstered furniture, ivory articles, etc.; then this rate was extended to all tobacco products including biris, and to cycles and cycle parts. In October of the

same year the general rate itself was increased to this level. Certain goods like mustard oil, cotton cloth, coal and coke continued to be taxed at three pies per rupee and the tax on despatches outside the State also continued to be leviable at the old rate of three pies per rupee. In April 1949, foodgrains were made liable to sales tax at three pies. The tax on luxury goods was increased to nine pies per rupee, except in the case of despatches outside the State where the rate remained at three pies until the Constitution intervened to prohibit the levy of sales tax on despatches of goods outside the State. The most important change made thereafter was during 1950, when the exemption granted to sales of raw materials to manufacturers and processors for manufacturing or processing of goods for re-sale was withdrawn in order to make up part of the loss which had resulted from the Constitutional restrictions. The list of luxury goods has been enlarged. The rate of tax on rape seed and oil, *kari* salt and raw jute has, however, been reduced from six pies to three pies.

*Bombay* - In Bombay, the main features of the tax as first introduced in 1946 were these: (i) the minimum turnover for taxation was fixed at Rs 30,000 a year; (ii) sales by a registered dealer to another of goods either for re-sale or for manufacture of other goods for sale were exempt; (iii) sales of goods despatched to an address outside the Bombay State were also exempt. The rate of the tax was six pies per rupee. A large list of exemptions was incorporated in the Act. The basis of the tax was more or less the same as in Bengal and Bihar. In 1947, on the recommendation of a committee which had been appointed to enquire into the system, the taxable limit was reduced to a turnover of Rs 10,000 a year in the case of importers and manufacturers so as to prevent loss of revenue through a large number of dealers being below the limit of registration. On the lines of the Bengal Act, voluntary registration was provided for dealers having turnovers between Rs 10,000 and Rs 30,000 a year. In 1948, the higher rate of one anna per rupee was levied for the first time on certain luxury articles. The list of luxury articles was enlarged in 1949 and despatches to persons outside the State were also made liable to tax at rates

half of those leviable on sales within the State. With the coming into operation of the Constitutional restrictions, the State lost its tax receipts estimated at Rs four crore on sales of goods despatched outside the State. To make up this loss and to meet the growing expenditure on schemes under the Five Year Plan, the single-point system was changed in 1952 to a multi-point one, the rate of general tax being three pies per rupee. A special tax was levied, in addition, at the first stage of sale, at rates varying from three pies to nine pies per rupee on certain luxury articles. The enactment of the Essential Goods Act created a further complication in that some of the essential goods which were taxed previously had to be taxed at not more than the original rates. The exemption previously granted in respect of raw materials used by industries was withdrawn and certain important raw materials like cotton, oilseeds, yarn (other than cotton yarn which continued to be exempt), were charged lower and concessional rates of taxes. However, in view of the several representations from trade and industry regarding the hardships suffered by them under the multi-point tax, the Bombay Government felt that its system required change and, in December 1953, passed the present measure under which a two-point sales tax is being levied since 1st April, 1954. Under this system, a 'sales tax' at the rate of three pies per rupee on ordinary goods and at rates varying from six pies to fifteen pies in the rupee on special goods, is levied at the first stage of sale and what is termed by the Act a 'general sales tax' is levied at the last stage of sale at the rate of six pies per rupee. In addition to the list of exempted goods, concessional rates are charged on numerous articles. Raw cotton, cotton seeds, artificial silk yarn, hides and skins, raw silk, and silk yarn, raw wool and woollen yarn and staple fibre yarn are charged to a lower rate only at the last stage. Such of the 'essential goods' as are not either exempted or taxed at a lower rate are made liable to the last point tax of six pies, i.e., to the same rate as was levied under the 1946 Act. To facilitate the *entrepot* trade of Bombay, authorisation certificates are granted to dealers whose turnover in respect of despatches to places outside the State

exceed Rs 50,000 and, subject to certain conditions, they can send goods free of tax to outside places. Sales between intermediate dealers are similarly excluded from the tax at the last stage by a system of licences which are issued to those dealers whose turnover of sales to registered dealers exceeds Rs 50,000 year. Sales to licensed manufacturers of raw materials for use in manufacturing goods for re-sale are also exempt from the last point tax. To equalise the incidence of the tax on goods which are imported, not for re-sale, but for consumption by registered dealers like producers or manufacturers, a purchase tax is levied at rates equal to the first-stage sales tax. Similarly, with a view to preventing evasion of the tax on purchases by unregistered dealers from outside the State of goods notified from time to time by Government, a purchase tax is leviable on these at rates equal to the corresponding sales tax rates. For the present, this purchase tax is levied only on motor vehicles, chassis of motor vehicles and arms and ammunition.

*Uttar Pradesh* - The sales tax was introduced in Uttar Pradesh on 1st April 1948 and was levied on a multi-point basis with a few exemptions. All dealers with annual turnovers exceeding Rs 15,000 were liable to the tax. A few months later, a larger number of exemptions were notified. Some of these like cereals, pulses, flour, *gur*, fish, salt, fertilisers, coal, fuel wood, kerosene, *ghani* oil, paper, etc., were exempted completely while some like bones, bullion and specie, army canteens, cotton waste, cooked food, lubricants, raw cotton, hides and skins, medicines and pharmaceutical preparations, tobacco (*hookah*), etc., were exempted on payment of annual fees. Certain articles were made taxable at a single-point only at three pies and six pies per rupee while some others were made taxable at nine pies and one anna per rupee. In September 1948, the latter rates of nine pies and one anna per rupee were brought down to six pies per rupee to bring about greater uniformity in the tax system. More changes in the rates were made in 1952, when biris, matches, jute goods and *khandsari* sugar were made taxable at one point at six pies while cigar, cigarette and pipe tobacco were taxable at nine pies. The rate of tax on crystal sugar has also

been raised to six pies per rupee in 1953. Originally, the Uttar Pradesh Sales Tax Act extended to forward contracts in commodities even when such contracts did not result in delivery of goods, but a judicial decision was given that the levy of a sales tax on such contracts is *ultra vires*. The recent amending enactments make only such changes as are necessitated by the Supreme Court's decision on inter-State sales and other judicial decisions. At present, in Uttar Pradesh, there are four types of sales of goods: (i) those exempted from the tax or excluded from the Act; (ii) those which are exempted on payment of prescribed annual fees; (iii) those which are made taxable at three pies per rupee like edible and non-edible oils, tanned leather and diesel oil, or at six pies like biris, cement, mill cloth, sugar, matches, motor vehicles, radios, glassware, etc., or at nine pies like cigars, cigarettes and pipe tobacco; and (iv) those that are taxable at the multi-point rate of three pies per rupee.

*Madhya Bharat* - The sales tax in Madhya Bharat is of a selective type and is levied mainly on importers and manufacturers. The tax was levied in 1950 to replace the internal customs duty on imports. The taxable quantum is Rs 5,000 a year for importers and manufacturers and Rs 12,000 for others. Sales tax is levied also on sales of goods during fairs and exhibitions. The turnover for this purpose is Rs 450 per month, instead of Rs 5,000 a year. The rates of tax vary from three pies per rupee to two annas per rupee. When the tax was introduced in 1950, the rates were the same as the customs duties on imports; but these were subsequently reduced. Gold and silver ornaments, vegetable oils and tobacco used in making biris are taxed at three pies per rupee; biris, cement, cotton cloth, metals and metalware, sports goods, paper, agricultural machinery, etc., are taxed at six pies per rupee; tea, coffee, cigars and cigarettes, silk and silken goods, woollen goods, clocks and watches, motor vehicles, etc., are taxed at one anna per rupee while foreign liquors, arms and ammunition are taxed at two annas per rupee. On a majority of articles, the tax is collected from importers and manufacturers; on only a few commodities is it collected from other types of dealers such as

wholesalers or retailers. The exemption list is fairly large and covers essential goods, important raw materials, *ghani* oil, etc.

#### *Finance Ministers Conference, 1948*

5. From the foregoing account of the different main features as they have developed in certain typical States, it is clear that along with the growing complexity of the systems also grew the need for all-India co-ordination. Prompted by revenue needs, many States had by 1948-49 started levying taxes on exports. A number of States had so defined the term 'sale' as to include within that term all sales of goods which were actually within the territories, irrespective of the place where the contract of sale took place. Some of the measures involved the taxation of various raw materials and of goods entering inter-State trade more than once; these measures evoked considerable opposition from trade and industry. A number of problems arose and, in order to consider these, the Government of India convened a conference of the Finance Ministers of States in October 1948. After a preliminary discussion, a committee of officials was appointed to investigate the possibility of achieving a certain degree of uniformity in regard to the taxation of inter-State trade in certain essential commodities, raw materials, manufactured articles, etc., which were of all-India importance. The Officials' Committee made certain recommendations which, because of their special relevance, we reproduce below:

- (i) No sales tax should be levied on exports to other States of the following commodities:

Grains and pulses, flour, *atta* and *maida*, matches and kerosene.

- (ii) A ceiling of three pies in a rupee should be fixed in the case of the following industrial raw materials exported from one Province to another:

Coal, cement, steel, cotton and cotton yarn, hides and skins, oilseeds, rubber, minerals and jute.

If the sales tax is levied subject to this ceiling by the Province exporting the material, the Province importing it should not charge any further sales tax, if sold to a registered manufacturer for purposes of his manufacture.

- (iii) A ceiling of three pies in a rupee should be fixed for the sales tax on the following goods exported from a Province:

Textiles, plant and machinery, vegetable oil products and sugar.

It will be open to the Provinces to levy a higher tax on internal consumption if they like.

- (iv) A uniform tax of one anna in the rupee (three pies in the case of bullion specie) should be levied on the following luxury articles:

Bullion and specie, jewellery, refrigerators, motor vehicles, radios, gramophones.

This tax should be levied at the point at which sales take place to the actual user.

- (v) No Province should charge any sales tax on a commodity exported by it if on that same commodity it does not levy a tax on its internal consumption.
- (vi) No sales tax should be levied on agricultural implements worked by human or animal power.
- (vii) In the case of commodities subject to multiple point sales tax, the ceiling prescribed above should apply to the total incidence of the tax.

#### *Constitutional restrictions*

6. These recommendations were then considered by the Finance Ministers' Conference. While there was general agreement about the principles underlying the recommendations, some of the State Ministers wanted time to consider the proposals in detail. But eventually there was so much disagreement that little could be achieved by way of tangible results. Only a few States gave effect to the proposals. Subsequently,

the Drafting Committee of the Constituent Assembly considered this question and proposed the incorporation of provisions in the Constitution restricting the powers of the State Governments in respect of the levy of sales tax in the course of foreign trade and inter-State trade and on essential commodities. These provisions were again considered at a conference of Chief Ministers and Finance Ministers. The proposed provisions were opposed by many States on account of the loss which would be entailed on them by the exclusion of foreign, and (in particular) inter-State, trade from the purview of their sales taxes. The loss, it was clear, would be particularly great for the States which produced important raw materials or manufactured articles. The provisions were, however, finally incorporated in the Constitution as Article 286.

#### *Article 286 of the Constitution*

7. Under Entry 54 of the State List in the Seventh Schedule to the Constitution, the States have been empowered to levy "a tax on sales or purchases of goods other than newspapers". This power has, however, been restricted in various ways by Article 286 which reads as follows:

"286. (1) No law of a State shall impose, or authorise the imposition of, a tax on the sale or purchase of goods where such sale or purchase takes place -

(a) outside the State; or

(b) in the course of the import of the goods into, or export of the goods out of, the territory of India.

*Explanation* - For the purposes of sub-clause (a), a sale or purchase shall be deemed to have taken place in the State in which the goods have actually been delivered as a direct result of such sale or purchase for the purpose of consumption in that State, notwithstanding the fact that under the general law relating to sale of goods the property in the goods has by reason of such sale or purchase passed in another State.

(2) Except in so far as Parliament may by law otherwise provide, no law of a State shall impose, or authorise the imposition of, a tax on the sale or purchase of any goods where such sale or purchase takes place in the course of inter-State trade or commerce:

Provided that the President may by order direct that any tax on the sale or purchase of goods which was being lawfully levied by the Government of any State immediately before the commencement of this Constitution shall, notwithstanding that the imposition of such tax is contrary to the provisions of this clause, continue to be levied until the thirty-first day of March 1951.

(3) No law made by the Legislature of a State imposing, or authorising the imposition of, a tax on the sale or purchase of any such goods as have been declared by Parliament by law to be essential for the life of the community shall have effect unless it has been reserved for the consideration of the President and has received his assent".

In brief, the States are prevented from taxing (i) sales or purchases in the course of trade outside the territories of India, (ii) sales outside the State of levy where these sales result in delivery for consumption of goods in another State, and (iii) sales in the course of inter-State trade and commerce. Moreover, on commodities declared to be 'essential' by Parliament, the State's power to impose the tax has been made subject to the prior approval of the President. To give some time to the States to adjust their sales tax levies, the President was empowered to postpone to the end of March 1951, the date for the coming into operation of the exemption of inter-State trade from sales tax. Under this power, the President promulgated an order extending the period to that date. As a result of the restrictions imposed on the taxation of inter-State trade transactions, there was a large diminution in the sales tax revenue of several States. Firstly, there was a direct loss of revenue from the abolition of the sales tax on exports, the loss being particularly heavy in States like Bombay, Bihar, Madhya Pradesh, Orissa and Assam. Bombay lost revenue to the extent of about Rs 4 crore, Bihar of about Rs 2½ crore,

Madhya Pradesh, Assam and Orissa of about a crore each. States like Madras, Uttar Pradesh, Mysore and Travancore-Cochin, which have been levying a tax on exports under a multi-point system, also lost their revenue on the last stage of sale in the course of inter-State trade. Secondly, because of these restrictions, there was greater scope for avoidance of tax, entailing an indirect loss of revenue on almost all States. Traders in one State started to sell direct to unregistered dealers and consumers in another. Similarly, consumers of valuable commodities tried to get these from dealers in another State rather than buy the articles from their local dealers. The practice grew for sales of goods within a State itself to be shown in the books of accounts as having been made to fictitious dealers outside the State and the goods having then been re-sold by those dealers to consumers within the State. For valuable commodities like motor vehicles, jewellery, watches, etc., this practice became very common. On transactions that could be shown to be in the course of inter-State trade, the 'exporting' State was prohibited under Article 286 from levying the sales tax; and if the goods delivered as a result of these transactions were shown to be received by individual consumers or unregistered dealers neither could any tax be levied on them by the 'importing' State. Thus, many of these transactions escaped sales tax altogether.

#### *Readjustment of sales tax systems by the States*

8. The loss of the revenue resulting from the provisions of the Constitution relating to inter-State trade coupled with the need to find money for the expenditure on developmental activities, compelled the States to resort to various measures to readjust their sales tax systems to the changed circumstances. Different measures were taken by different States. The Bombay State, which all along had a single-point tax and had exempted sales of raw materials purchased by manufacturing industries, changed over to a multi-point tax on the lines of the Madras system, whereunder it levied a tax at all stages of sales including sales of raw materials to manufacturing industries (though in respect of certain important raw materials a lower rate of duty was levied and

certain other concessions like taxing at only one stage were also granted). When this system was found unsuitable to its trade and industry, the State devised a two-point system under which the tax is levied at different rates on the first stage of sale and the last stage of sale in the State. States, like Bihar and Orissa, continued the single-point system, but withdrew the exemption previously applicable to sales of raw materials to processing and manufacturing industries. In Madhya Pradesh and Assam, this exemption was restricted to raw materials used in manufacturing goods for sale and delivery in the State for consumption within the State itself. The Hyderabad State, which in the main exports agricultural raw materials, imposed a purchase tax on dealers who bought such materials within its territory. By this change in the point of levy of the tax, it in effect taxed the sale of exportable goods, while at the same time adhering technically to the terms of the Constitutional restrictions.

#### *Supreme Court's interpretation of Article 286*

9. When Bombay changed over to the multi-point tax, its new Sales Tax Act was challenged in the Bombay High Court, which held that the Act was *ultra vires* on the ground that it did not take into account the Constitutional restrictions. The Bombay Government promulgated an ordinance to satisfy the legal requirements and keep alive the sales tax on the multi-point basis, and also appealed to the Supreme Court against the decision of the Bombay High Court. Earlier, the Travancore-Cochin Government had also appealed to the Supreme Court against their High Court's decision that the Constitutional restriction relating to "sales or purchases in the course of export or import out of the territories of India" covered not only the first purchase in the course of import and the last sale in the course of export, but all intermediate transactions, and that, accordingly, all such transactions were exempt from the State sales taxes. In deciding the appeal filed by the Travancore-Cochin Government, the Supreme Court ruled that "whatever else may or may not fall within Article 286(1)(b), sales and purchases which themselves occasion the export or import of goods, as the case may be, out or into



the territory of India came within the exemption." In the other appeal, the Supreme Court decided that "Article 286(1)(a) read with the Explanation prohibits taxation of sales or purchases involving inter-State elements by all States except the State in which the goods are delivered for the purpose of consumption therein. The latter State is left free to tax such sales or purchases which power it derives not by virtue of the Explanation but under Article 246(3) read with Entry 54 of List II". This decision of the Supreme Court has been interpreted by the State Governments as giving them power to tax non-resident dealers on their sales of goods to consumers or dealers within their respective territories. Several States issued notices for payment of tax to dealers in other States. They also demanded that all the exporting non-resident dealers should get themselves registered under their own Sales Tax Acts and submit returns of their tax assessed in the same manner as the registered dealers within their own territory. This created difficulties for the trade and industry, as it meant that an exporting dealer had to register himself and be liable to the tax not only of his own State but also of all the States to which he exported his goods. On account of the very great trouble and inconvenience entailed by this procedure on the despatching dealers, particularly of States in which big distributive centres were situated, acute dissatisfaction was created among trading circles, and several representations were made by Chambers and Associations and other representative bodies of trade and industry to the State Governments and to the Government of India.

#### *Officials' conference of 1953*

10. For examining the various representations made to them, and in particular for considering how best the grievances of the trading interests could be met consistently with the interpretation of Article 286 by the Supreme Court, the Government of India convened a conference of officials in November 1953. It was generally agreed at this Conference that the importing States should not insist upon the non-resident dealers to present themselves at the various State headquarters to get their books of accounts examined and to have their liabilities assessed, but should

assess the liability on the basis of the returns which these dealers would supply from the places where they carried on business. Where such a course was necessary, it was agreed that the receiving State should depute one of its own officers to the State where the non-resident dealers resided and get the points in dispute settled. For purposes of check and verification, it was decided that each State should supply to the other States the names of dealers who exported their goods to other States and claimed exemption from its sales tax; as a long term solution, the proposal was also put forward at this Conference that instead of the non-resident dealers being taxed by the importing States, a purchase tax could be levied by those States on the dealers in their territories when the goods were delivered to them in the course of inter-State trade. This, it was urged, would confine the tax operations of each State to traders resident within its boundaries and obviate the inconvenience caused to non-resident dealers by the efforts of importing States to collect the sales tax from them. While the reciprocal arrangements for the supply of information have been agreed to by most of the States and are being implemented, not all States have agreed to the proposal regarding the introduction of a purchase tax. Prominent among the States to which this proposal has not been acceptable are Bihar and Assam. Bihar has pointed out that "pattern and organisation of the trade in the State is such that any shifting of the incidence from the seller to the buyer would at once create insurmountable difficulties", while Assam considers that a purchase tax "will not confer on Assam the full benefits she is entitled to". A purchase tax may not yield to these States the same revenue as a tax on non-resident dealers for the reason that in the case of several of their raw materials like tea, coal, etc., there are no intermediate purchases by internal wholesalers but only direct sales to other States. Multi-point States like Madras are also opposed to the proposal to levy purchase tax. They point out that by taxing non-resident dealers they are able to get an additional stage of sale on which to levy the tax. Thus they are able to make up to some extent the loss that has occurred through the exemption of sales at the last point in the course of inter-State trade. If, however, they

levy a tax on the purchases made by internal dealers, the tax would have to be levied on the same dealer first on his purchases and again on his sales which under their existing sales tax structure is not permissible. The present position regarding the levy of a purchase tax is therefore still uncertain; and the States have started recovering the tax from non-resident dealers by making them liable to registration under their own Sales Tax Acts. This liability was made retrospective by some States, i.e., payments were called for in respect of sales from 26th January 1950, the date on which the Constitution came into force. It was agreed at the Officials Conference that the tax should not be recovered with retrospective effect from any date prior to 1st April 1953; some of the States have even fixed a later date, viz., 1st January 1954, as the date of commencement of this particular levy. Certain State Governments have already opened offices in other States for the collection of returns and taxes from non-resident dealers.

#### *Essential Goods Act, 1952*

11. Besides prohibiting States from levying any tax on sales or purchases of goods in the course of foreign trade, on sales or purchases of goods delivered in another State for consumption therein and on sales or purchases of goods in the course of inter-State trade or commerce, the Constitutional provisions also enjoin it on the States not to tax sales or purchases of goods declared by Parliament by law to be essential for the life of the community, except with the previous assent of the President. Parliament has already enacted the necessary law, viz., Essential Goods (Declaration and Regulation of Tax on Sale or Purchase) Act, 1952, and the following goods have been declared as 'essential' for the life of the community:-

- (1) Cereals and pulses in all forms, including bread and flour, including *atta*, *maida*, *suji* and bran (except when any such article is sold in sealed containers).

- (2) Fresh and dried fruits, sugarcane, coconuts, vegetables, edible tubers, vegetable and flower seeds, bulbs and plants, excluding orchids [except
  - (i) any medicine prepared from any one or more of such articles; and
  - (ii) when any such article is sold in sealed containers.]
- (3) Fresh milk, whole or separate, and milk products, including butter, *ghee*, *chana*, *khoa*, but excluding sweetmeats.
- (4) Meat, fish and eggs (except when any such article is sold in sealed containers).
- (5) Edible oils, and oilseeds from which edible oils are extracted.
- (6) *Gur*.
- (7) Salt.
- (8) All cloth, woven on handlooms, coarse and medium cotton cloth made in mills or woven on powerlooms.

*Explanation 1.* - 'Coarse cloth' means any cloth in which the count of warp yarn employed (excluding the border) is below 17s. (whether single or folded).

*Explanation 2.* - 'Medium cloth' means any cloth in which the count of warp yarn employed (excluding the border) is 17s. or finer but is less than 35s. (whether single or folded).

- (9) Raw cotton, including ginned and unginned cotton or *kapas*, cotton thread, cotton yarn, cotton seeds, jute seeds, raw jute, sannhemp and *mesta*.
- (10) Hides and skins.
- (11) Fertilisers and manures, agricultural machinery and implements, including parts of such machinery and implements.
- (12) Cattle feeds.
- (13) Coal including coke and other derivatives, petroleum and petroleum products, including kerosene and motor spirit.
- (14) Iron and steel.
- (15) Books, exercise books, slates and slate pencils and periodical journals.

### *Operation of the Essential Goods Act*

12. It is obvious that the object of restricting the power of the States to levy a tax on the sale or purchase of 'essential goods' is to achieve some degree of uniformity in the tax burden on those goods, and not necessarily or in all cases to eliminate altogether the sales tax on such goods. When the Bombay Government sought the assent of the President to tax some of the 'essential goods' under their new multi-point tax system, the assent was given on condition that the tax burden on these goods should not in any event exceed the previous tax burden under the single-point system. This seems to indicate that the policy underlying the restriction is one of freezing the existing tax levies on these goods and of ensuring that new proposals to tax them are confined within reasonable limits. On the whole, however, both the provision and the list of 'essential goods' have evoked a great deal of criticism from State Governments. Firstly, the States which taxed these goods prior to the coming into effect of the Constitution and the Parliamentary enactment are at an advantage as they are unaffected by this restriction, while the States which now attempt to tax them must obtain the assent of the President. Secondly, the list of 'essential goods' includes goods which cannot, except by a wide interpretation, be regarded as 'essential' to the life of the community. The dissatisfaction has been aggravated by the fact that on some of the goods declared essential to the life of the community the Central Government themselves levy relatively high taxes in the form of excise or customs duties.

### *Origin and later developments of the different sales tax systems*

13. Having reviewed in some detail the changing features of the sales tax systems of certain States, as also the administrative and constitutional developments which have taken place, we are now in a position to sum up the main trends and to relate them to the different conditions in which those systems have originated or to which they have adapted themselves. The relevant factors are many. First of all, there is the

extent of financial need which the particular sales tax system is designed to meet. Secondly, the period in which the need has arisen may be one of relatively low prices coupled with a buyer's market (as in 1939 when Madras introduced the tax) or one of high prices and inflation (as when Bombay and a number of other States adopted the sales tax as one of their more important fiscal measures). Thirdly, there can be discerned in each State a definite degree of relationship between the tax system initially adopted and certain relevant characteristics of the economy of the State. The characteristics may be described as the pattern of consumption, the pattern of trade and the pattern of production in the State. Fourthly, apart from the origin of the tax system in different States, the later developments of the system have an intelligible connection with the further financial needs experienced by the States in the context of increased expenditure (e.g., on account of the Five-Year Plan) or decreased revenue (e.g., on account of Prohibition) or some other occasion for radical financial re-adjustment (e.g., merger and integration). Fifthly, certain types of alteration in the tax system common to different States are seen to be attributable to the State Governments' efforts to adapt their tax to new conditions, legal and other, created by the Constitution. Accordingly, with reference to the development of the main systems, the present summing up may be related to (i) the origin of the system, (ii) the adaptation of the system to growing financial needs, and (iii) the adaptation of the system to conditions created by the Constitution.

(i) *Origin of the system.* - We have alluded to there being in some instances an implicit relationship between initial choice in favour of a particular system of sales tax, viz., the one originally adopted by the State, and the pattern of consumption, trade and production in that State. We would recall in this connection one of the distinctions we have drawn in Chapter I between the multi-point and single-point systems. The former, we said, may be regarded as having been occasioned by the decision of Government to collect the tax from a large number of dealers, big, medium and small, and on a large number of articles, including what are relatively essential,

and at the same time to charge so low a rate that it will not constitute a serious hardship even if the tax is paid more than once on the same article. The single-point tax, we stated, may be said to follow from a different kind of decision; to levy the tax at a relatively high rate, to exempt essential articles like foodgrains and cheap cloth, and to place the liability for the tax on a limited number of dealers who may be described as large and medium. In very broad terms, it may be said that a single-point tax is specially appropriate in relation to urban conditions, and the multi-point tax to semi-urban and rural conditions. A number of other factors too would of course have to be taken into account. Madras, which was the first State to levy a sales tax, may in retrospect be said to have adopted the multi-point system mainly because of a combination of the following factors; a predominantly rural economy, low prices and a buyers' market (1939), and financial needs which at that time were not great. Bengal adopted a single point system in 1941 in the context of a large urban trade and consumption, predominant industrial and manufacturing interests, and a period of rising prices. Bombay adopted the Bengal system in circumstances which were broadly analogous. Uttar Pradesh, which presents certain mixed features, adopted a combination of the two systems. Some of the States which followed, levied the tax as an anti-inflationary measure, while others levied it to meet the increasing cost on developmental activities or to replace (in the case of certain Part B States) internal customs. These States have in some instances followed the system of the neighbouring States where economic conditions were more or less similar.

(ii) *Adaptation of the system to growing financial needs.* - While initially the systems of sales tax were designed to suit relatively modest revenue needs - together with the prevailing economic conditions and the patterns of consumption, trade and production - they were adjusted, modified and altered to conform to changing circumstances and growing revenue needs. Madras which levied the multi-point tax started with the low rate of half per cent; and thereafter even reduced it to quarter per cent. During the War, however, the rate was increased

to one per cent. Still later, in order to meet new liabilities, the rate was changed to three pies in the rupee, and certain 'luxury' goods were charged a higher rate (at the first point of sale) in addition to the ordinary one thus enhanced. Most States adopted higher rates for specified luxury goods. Further, their increased revenue needs drove Bihar and Bombay to extend the levy to inter-State exports at half the rates on internal sales; when this came to be prohibited by the Constitution, Bihar withdrew the exemption on sales of raw materials to producers and processors within its State and imposed a tax on foodgrains, while Bombay changed its system to a multi-point tax at the rate of three pies in a rupee (yielding a total tax of about nine pies per rupee against its previous rate of six pies per rupee). Recently, as we have seen, Bombay has again changed its system to a double point tax, with the total rate of tax related to a level of nine pies in the rupee. Assam, Punjab and Orissa, which had a low rate of tax to start with, increased their rates. The other States started with a high rate of tax or where they had a tax only on certain selected goods (Hyderabad, Saurashtra) changed it to a general tax covering all goods other than those specifically exempted.

(iii) *Adaptation of the system to conditions created by the Constitution.* - The prohibition imposed under the Constitution on the powers of the exporting States to levy a sales tax on goods sold for consumption in another State has affected the revenues of most of the States, particularly those producing raw materials and manufactured goods. The loss was not as great for multi-point States as for the single-point ones; this was because the restriction did not apply to sales in the State prior to the last point of sale for export. Further, the Constitutional provision took no cognizance of the registered dealers; it equally extended to purchases by registered dealers, unregistered dealers and consumers. This, as already mentioned, gave rise to large scale evasion, since inter-State sales to unregistered dealers and consumers escaped the taxation of the importing State no less than that of the exporting State. In order to make up the loss which resulted, in part directly and (through the evasion thus

made possible) in part indirectly, from the Constitutional restrictions, different States have adopted different measures. Punjab has withdrawn the minimum limit of taxable liability for importers, with the result that every importer whatever the value of his imports is now liable to the sales tax. Hyderabad has levied a purchase tax on the purchases of raw materials by the exporters. The Madhya Pradesh Government have, by an amendment of their Sales Tax Act, withdrawn, except in the case of cotton, the exemption on sales of raw materials used in the manufacture of goods sold outside their area. Bombay has levied a purchase tax on goods brought from outside by its unregistered dealers and consumers, though for the present this tax is imposed only on motor vehicles and arms and ammunition. Assam has recently imposed a carrier tax on tea and jute which are its main exportable raw materials.

#### *Collection of tax from non-resident dealers*

14. Judicial interpretation, as in its turn interpreted and understood, has introduced further complications. On the basis that the right to levy the tax accrues to the State where the goods are delivered for consumption, the importing States have held themselves entitled to collect the tax from non-resident dealers. With Bengal as one of the notable exceptions, practically all States have started levying taxes on non-resident dealers. In some States (e.g., Bombay), a purchase tax has been imposed on the internal buyers of certain external commodities, e.g., a mill purchasing cotton from outside the State.

#### *Effect of changes in sales tax measures on trade, consumer and Government*

15. The different measures undertaken by the States to adapt their sales tax systems to their growing revenue needs, to the restrictive provisions of the Constitution and to the conditions resulting therefrom have made these systems very complicated. The high rate of tax in multi-point States has to a certain extent affected the structure of trade, e.g., by tending to eliminate intermediaries; and it has, in some instances, even involved

loss of revenue to those Governments. The Travancore-Cochin Sales Tax Committee's Report emphasises this feature and suggests the levy of a single-point tax at a high rate on certain selected goods. Further, the high rate of tax has necessitated the grant of a large number of exemptions even under a multi-point tax (e.g., Mysore, Travancore-Cochin), making the maintenance of accounts difficult for the small dealers. Since the cost of production increased on account of a high rate of levy at every stage, these States had either to levy reduced or 'concessional' rates on the relevant commodities or make them liable to the tax at only one point. In the single-point States: (i) the levy of tax on raw materials as in Bihar; (ii) the increase in the rates from six pies to nine pies as in Bengal or Orissa; (iii) the extension of the liability to all importers without any minimum limit as in the Punjab; and (iv) the taxing of raw materials used by industries and the varying rates of tax on different goods under the two-point system in Bombay, have all combined to increase the cost of production to enhance the burden on consumers and to multiply the difficulties of the dealers from whom the tax is collected. Further, as regards the dealers, the measures taken by the importing States to exercise jurisdiction on those resident in other States have greatly added to their harassment. It is these factors that have been responsible for the growing agitation for the removal of the sales tax from the field of State taxation. They have also given rise to large scale evasion of tax by dealers and by consumers, and to malpractices and corruption in the departments responsible for collecting the tax. These and other problems have occasioned various suggestions with regard to the sales tax. We examine some of the suggestions in the next chapter.

### CHAPTER III

#### EXAMINATION OF CERTAIN SUGGESTIONS

##### *Range of the suggestions*

The suggestions which have been put to us in respect of the sales tax some of them in the context of specific issues raised in our questionnaire, cover a range which is both wide and varied, even if it does not include much that can be said to be

unfamiliar. We need refer only to the more important of these suggestions. At one end, they are concerned with the possible enlargement of the scope of the sales tax with a view to increasing the revenue from it. At the other, what is proposed is the virtual abolition of the sales tax through the taking over of some of its functions by different taxes which have existed long before the sales tax itself; in particular, customs, excise and octroi. Between these two extremes are different proposals for modifying the present systems of sales tax so as to secure that the levy is simple, evasionless, and hardship to the dealer reduced to a minimum. An aim that is common to many of the suggestions is to ensure better coordination between the States and, through such coordination, to eliminate the difficulty now experienced on account of the attempts of State Governments to collect the tax from non-resident dealers. Not a few of our respondents appear to entertain the belief that some one system must somewhere exist which, if searched for and found and then installed in place of the variety of levies that now obtains in the States, will have the two-fold effect of remedying all the ills and of retaining all the revenue. Among the systems thus advocated for universal adoption are a selective sales tax, a "first stage" sales tax, a low multi-point tax, and a purchase tax. Finally, there is the proposal that the sales tax should be removed altogether from the State List and placed within the purview of the Union; we reserve the consideration of this particular proposal for the next chapter, in which we examine the place of the Union in the system of sales taxation as it has developed in this country.

#### *Suggestions about enlarging the scope of sales tax*

2. We may start by examining the proposals for either enlarging the scope of the sales tax or for ensuring a larger revenue from it. Under the Constitution, as has been noted before, the State Governments can levy a tax on "the sale or purchase of goods other than newspapers". Services, contracts for sale not resulting in delivery of goods (e.g., transactions in futures markets)

and sales or purchases of newspapers are therefore excluded from the scope of the States. The Central Government can levy a tax (other than stamp duty) on transactions in futures markets. It can also levy a tax on sales or purchases of newspapers and on advertisements appearing therein. None of these taxes has so far been levied by the Central Government. Sales of services are not specifically liable at present to be taxed either by the States or by the Central Government. The advisability of extending the sales tax to one or more of the items thus left out has been suggested by some, though it has not found any wide support.

#### *Feasibility of sales tax on 'services'*

3. Taking 'services' first, these can be divided into: (i) services proper, (ii) those entering in a special manner into the making of certain classes of goods, and (iii) those forming part of a total transaction which includes the rendering of services as well as the sale of goods.

There would be serious administrative difficulties in the levy and collection of a tax on specific services from those who render them. Sales of services are not in all cases covered by written documents. Evasion would therefore be easy. Where the same persons sell both services and goods and the tax rates are different, assessment would be difficult. Moreover, taxes on services would, in many cases, be a duplication of profession tax. For these and other reasons, almost all the States are opposed to the extension of the sales tax to services proper. We agree with them and do not recommend the extension of the sales tax to services.

The second category purports to cover goods such as paintings, photographs, etc., the sale of which obviously falls within the definition of 'sales of goods'. The only distinguishing feature is that in certain instances the sale value of such articles is to a larger extent related to personal skill or other specialised nature of the services which have gone into its making than is the case with the generality of articles. At the same time, there are hardly any goods bought by the consumer into the making of which some degree of service or skill does not enter, and it is obviously

difficult to draw a distinction between 'ordinary' articles and 'special' articles on the basis of the degree of service or skill which has entered into their making. In practice, certain States exclude special categories such as photographers, etc., from the scope of the sales tax. We consider it unnecessary to make any specific recommendations in this context.

The third category may be illustrated by a bill from a hotel which covers both food and services or by a building contract in which the charges made cover the value of services as well as the cost of materials. In such cases, the only difficulty which presents itself is that of separating the charges for goods sold from all other charges. For this purpose, different formulae for varying contexts are adopted by different States and we consider the position to be generally satisfactory.

#### *Sales tax on transactions in forward markets*

4. It has been held by the Uttar Pradesh High Court that State Governments have no power to tax transactions in the forward markets which do not result in delivery of goods and therefore do not result in a 'sale'. Irrespective of the legal position, we consider that the levy of a stamp duty would be a more appropriate way of taxing these transactions than a tax on sales. We also consider that the stamp duty is best recovered through the clearing house which every important forward market keeps or, if it does not, ought to be made to maintain. We deal with this subject at greater length in the chapter on Stamp Duties. Briefly, it would be impracticable to keep track effectively of individual transactions and of the parties to the individual transactions without the intervention of an organised clearing house. Moreover, the transactions in the forward market are not comparable to sales of goods in the ready market - the transference of risk through repeated sales and purchases without actual delivery is one of the main characteristics of many of these markets - and the rate of taxation on the resultant turnover would have to be so low as to make the levy itself wholly dissimilar to the sales tax as it is ordinarily operated.

#### *Sales tax on newspapers and on advertisements in newspapers*

5. Turning to the proposed levy of tax on the sale of newspapers and on the sale advertisements which appear in them, we may note that, prior to the passing of a repealing enactment by Parliament under the powers vested in the Union by the Constitution, newspapers were subject to a sales tax in Madras, while advertisements in newspapers were taxed in Bombay State. It is of course only the Union that can now levy either of these taxes. While the exercise of this power need not be ruled out for all time, there are certain considerations which arise from the present stage of development of the Press in this country and which have to be taken into account. There are many newspapers with relatively small circulation. To this category belong most of the newspapers which are published in the regional languages of the country. A sales tax would entail on these a degree of hardship disproportionate to the revenue; so would an advertisement tax to the extent that an increase in advertisement costs might be expected to have the effect of diverting advertisements from this class of newspapers. It would, therefore, be reasonable to postulate that a large variety of newspapers would have to be exempted from sales tax and advertisement tax in the event of these being levied at the present time. The exemptions will add to the difficulties of administering the tax. In any case, and apart from these exemptions, the revenue itself is hardly likely to be substantial, since various considerations relevant to the present condition of the Press in India would necessitate relatively low rates of levy. On the whole, therefore, we are of the opinion that the proposed sales tax and advertisement tax on newspapers would not, at this stage, be worth the fairly widespread opposition which may be expected and which *ex hypothesi* will be vocal.

#### *Feasibility of 'selective' sales tax levies*

6. We proceed to a discussion of some of the alternative schemes of sales (or purchase) tax suggested in replacement or modification of the existing systems. It has been urged by some that

the bulk of the receipts from the sales tax is derived from a few important commodities, and that it should be possible to derive the same revenue by restricting the levy of the tax to these specific commodities. This, it is urged, would make a relatively small number of traders liable to the tax and leave the majority of them free from the inconveniences and difficulties arising from the imposition of the tax on their sales. An analysis of the receipts according to commodities for a few States for which the information is available indicates that it would not be correct to assume that only a small number of dealers would be involved if the tax was confined to the principal commodities from which it is derived. In Madras, the items which yield the largest revenue are paddy and rice (Rs 164 lakh), provision stores (Rs 132 lakh) and mill cloth (Rs 139 lakh). In Mysore, the main receipts are from provision stores (Rs 21 lakh), cotton cloth (Rs 19 lakh), oil-seeds and vegetable oils (Rs 7 lakh), coffee (Rs 4 lakh), and hand-loom cloth (Rs 4 lakh). The figures for Orissa are: coarse and medium cloth (Rs 18 lakh), cotton and cotton yarn (Rs 4 lakh), and vegetable oils (Rs 3 lakh). The dealers who trade in these articles are spread over both urban and rural areas. If the tax was collected from them alone, therefore, the number of traders who would have to be registered would by no means be small or compact, nor would it be possible to claim for the resulting system that the burden of tax compliance was placed on those most able to bear it. Further, the restriction of the tax to a few selected articles of common consumption would, from the point of revenue, make it necessary to levy the tax at a high rate. To that extent, the incidence on the less well-to-do classes would be higher and the tax system more regressive than at present. On the other hand, a general sales tax, either multi-point or single point, would cover both a wider range of commodities and a larger number of dealers than a selective sales tax of the type suggested; in consequence, as compared with the latter, the general sales tax would in point of rate be lower and in point of incidence less open to objection.

#### *First stage single-point sales tax*

7. It is necessary to give somewhat more detailed consideration to the suggestion that what has been termed the 'first stage single-point tax' should be introduced in replacement of the existing systems. Foreign experience is sometimes cited in support of this proposal.

In certain countries, and in particular where the sales tax is levied by the Central or Federal Government of the country, the tax is often collected from the importers, manufacturers and wholesalers, e.g., Australia, New Zealand, Pakistan, Canada (Dominion sales tax) and U.K. (purchase tax). One advantage of such an arrangement, where the organisation of the trade as a whole makes it feasible, is that the tax can be recovered from a small, compact and readily supervisable body of dealers. The dealers, moreover, would be those best able to maintain the requisite records and accounts, even if the requirements were relatively complicated. Further, the consumer himself is not brought face to face with the tax as much as under a retail sales tax system where it confronts him every time he makes a purchase. In India, it is only in Madhya Bharat that the tax is levied at the first point, i.e., on the manufacturers, importers and wholesalers. Elsewhere, as we have seen, it is variously levied at all stages or two stages and, when levied at only one stage, this is usually the retail stage of sale.

#### *Conditions for a first-point sales tax*

8. The first-point tax, to be effective from the point of view of revenue, should be one which covers, directly or indirectly, an adequate segment of the totality of sales transactions. It is not necessary, of course, that every transaction should be brought within the operation of the tax; those pertaining to articles which may be ignored for revenue purposes (either as unimportant or as included among those exempted) may in any case be left out of consideration; but the majority of other transactions should be within the radial ambit of collection at the first stage. It is evident that this can happen only where the bulk of trade



and business in the relevant articles is so organised that it 'fans out' from a few big manufacturers, importers and wholesalers. In other words, the retail trade must get its supplies of goods almost entirely from such manufacturers, importers and wholesalers. These conditions will be found only in those countries in which both production and imports are large scale and organised. Where, on the contrary, production is medium or small scale, the points of production and import are relatively diffused, and trade for its part shares more or less the same characteristics, the first-point tax on manufacturers, importers and wholesalers would leave a large number of small producers and small traders outside the tax orbit and the revenue realised from the sales tax would be small. This difficulty would be so great as to make such a tax unworkable even if it was the Central Government that collected the tax; it would be much greater for the State Governments which, each within its own territory, would have to deal with one arbitrary part of the total organisation of production, import and distribution.

#### *Limitations of a first-point sales tax*

9. In view of the insistence with which the first-stage tax is advocated by those who regard it as a cure for the ills of the sales tax, it is desirable to examine in somewhat greater detail its different implications as well as its suitability to Indian conditions. The principal advantage that is claimed for the first-stage tax is that it renders administration easy as the tax-payers are smaller in number and more capable of complying with the requirements of the tax authorities. While this may be true of certain other countries - in Canada, it is estimated, a retail sales tax by the Dominion Government would have covered 250,000 dealers whereas its present tax covers only 34,000 dealers - it is not of valid application to conditions in this country. If the States in India were to adopt the first-point tax, the reduction in the number of dealers liable to tax would not be anywhere near being as substantial. A statistical analysis for Bombay, for example, has shown that in 1949-50, out of 62,145 registered dealers, 24,863 were retailers while as many as 37,282 were producers,

manufacturers and importers. The suitability of the first-stage sales tax for that State was examined by the Bombay Sales Tax Enquiry Committee, 1946. The Committee says:-

"A tax on producers, manufacturers or importers will, it is pointed out by its advocates, be easy to collect and will not involve any hardship to them. They point out that there will be a fewer number of such dealers to assess for the Sales Tax Department and the dealers being organised and well staffed, will not feel the burden of maintaining the additional accounts necessary for the tax. In our opinion, it will not be correct to say that all producers or manufacturers are organised and well staffed. There will be numerous small manufacturers and producers who are neither organised nor well staffed. There are workers in handicrafts, manufacturers of articles used in large industries, etc., who would be liable to pay tax under this system and who would find the necessity of maintaining accounts to suit the tax requirements at least as irksome as small dealers. Further, the work of the Sales Tax Department in checking evasion will not in any way, be easier. In the case of importers, the scope for evasion will be particularly large, as imports would not only be by rail or steamer, but also by road, through postal delivery or by coastal traffic. Moreover as most of the retailers themselves import some goods or other from abroad or from neighbouring Provinces or States, they would be liable to pay tax and have to maintain separate accounts of such imports. Accordingly, the number of dealers to be assessed will not be as small as the advocates of this system suppose it to be. It is evident therefore that under this system of taxation, there will not be much relief either to the dealers, or to the Sales Tax Department."

#### *Disadvantages of a first-point sales tax*

10. Moreover, the first-point sales tax has certain disadvantages as compared with a single-point tax such as is usually collected from retailers:-

- (i) If the goods sold by the importers and manufacturers pass through one or two additional stages before they reach the consumer, the effect of the tax will be cumulative; as the margin of traders' profit varies from commodity to commodity, the incidence of the tax on the final price to the consumer will vary according to this margin.
- (ii) Where the 'wholesaler' sells not only to retailers, but also direct to consumers, there will be disparity between the prices he charges to the consumers and those which the retailers charge.
- (iii) A single-point (retail) sales tax can be made applicable to a larger number of dealers and goods than the first-point tax. In terms of obtaining the same revenue, therefore, the rate of the first-stage has to be much higher than that of the single-point levy. To that extent it provides larger incentive for evasion.

#### *Suitability of first-point sales tax in certain cases*

11. A first-point sales tax, therefore, is not a suitable form of sales taxation for general adoption in this country. It has, however, certain limited uses as a part of, or in combination with, the other systems. Madras, Mysore, Uttar Pradesh and Bombay either levy a first-point tax or charge specially high rates on 'luxury' goods. The Bengal Government have recently introduced a first-stage sales tax on cigarettes, in replacement of the retail sales tax, in order to reduce evasion. According to the State Government, the extension of this tax to other articles will be possible only if the following conditions are satisfied by the particular commodity:-

- (1) it is not a raw material;
- (2) the manufacturers and importers are not too many in number and are generally such well-established parties that they cannot easily disappear;
- (3) if the commodity is exported out of the State, the manufacturers should themselves be the exporters, as far as possible; and
- (4) the imports, if any, should be so canalised as to admit of effective checks.

The conditions mentioned by the Bengal Government point to the same conclusion as we have indicated, viz., that only a limited use can be made in this country of the first-stage single-point tax.

#### *Sales tax on petrol*

12. It remains to mention in this context the special case of 'petrol tax', which in some respects is a variant of the first-stage tax at one point. The tax on petrol is imposed by a separate measure of sales taxation in most States, and the rate of the tax is much higher than that of the ordinary sales tax, being as high as six annas per gallon in many States. The suggestion is sometimes made that other articles should be selected for specific treatment analogous to that accorded to petrol, including a specially high levy. The essence of the petrol tax, from the point of view of system of levy, is that it is collected from wholesalers or from retailers, but not from both. In either case, of course, the points of distribution of petrol are well defined, relatively few and readily controlled. Further, there are special reasons why a rate of tax significantly higher than even the 'luxury' rates of sales tax has been practicable in respect of petrol. If a similar tax is to be levied on other commodities, they must satisfy certain requirements which petrol happens to fulfil. These conditions may be said to be as follows:

- (1) the article must be one which is channelled through a manageable number of dealers all of whom are in a position to keep the requisite accounts, give vouchers and so on;
- (2) it must not be one which is partly channelled through dealers of the above description and partly through others (who cannot maintain the accounts, give vouchers, etc.);
- (3) it must not be one which the consumer can readily buy outside the State of his residence, thereby avoiding or evading the tax or paying instead the lower tax of another State; and
- (4) it must be one which can 'bear' the tax which, for the special arrangements to be worthwhile, would have to be a relatively high tax.

Petrol, at one extreme, is almost a 'pure' example of an article which satisfies these requirements. Hardly any other article fulfils them in the particular conditions of import, production and distribution of this country; hence the need to fall back on the General Sales Tax for the larger part of the revenue derived in this context by State Governments.

*Feasibility of a low multi-point sales tax in all States*

13. We may now consider briefly the suggestion that a low multi-point tax might suitably be adopted by all States in replacement of their present systems. It is claimed that this will bring broadly the same revenue as at present to State Governments, while at the same time substantially reduce the difficulties now experienced by the trade. This proposal has in particular been urged by the retail dealers of States which levy a single-point tax. A low rate extending to all commodities without exception would no doubt make the accounts much simpler and to that extent be of great advantage to small dealers. Revenue and administrative considerations, however, make this suggestion unacceptable. A low rate - 1/4 per cent is what has been usually suggested by the sponsors of the proposal - will not, even if it is made applicable to all commodities, give the States the revenue which they now derive. The assertion to the contrary made by those who put forward this proposal is based on the assumption that most commodities change hands four times in the course of trading before they reach the consumer. This is certainly not true of foodgrains, for example, or of the products of animal husbandry, fisheries and small enterprises. We may refer to what the Madras Government have pointed out in defence of the sales tax it levies on foodgrains, viz., that for the larger part the cultivator consumes what he grows on his own field and that there are not more than two stages of sale before the foodgrains (other than imported ones) reach the urban consumer. Nor do other goods including 'luxury goods' usually pass through the four stages of sales assumed by the supporters of the proposal. Moreover, it would be inequitable

to levy the same rate of tax on essential commodities like foodgrains on the one hand and on goods such as motor vehicles and radios, on the other. Further, the proposal in the form in which it has been put forward involves the extension of the tax and, therefore, of registration, etc., to agriculturists and other primary producers in the rural areas, and to hawkers and other small or itinerant dealers in the urban areas. Since administratively this would be so formidable as to be wholly impracticable, exemptions would have to be given in respect of certain classes of commodities and the turnover limit so fixed as to exclude several classes of sellers. If this is done, and at the same time the present level of revenue sought to be maintained, the rate of levy would need to be much higher than 1/4 per cent. The Madras Government, for example, which, of all the States, have the smallest number of exemptions and exclude from the purview of the tax all dealers with a turnover of less than Rs 10,000 a year, obviously cannot obtain from a multi-point tax of 1/4 per cent the revenue which they now get on the basis of a rate of three pies in the rupee, or roughly  $1\frac{1}{2}$  per cent. A wide coverage for the sales tax is definitely an advantage, and we shall in a later chapter revert to this consideration; but the imposition of a multi-point tax of 1/4 per cent on all commodities and on practically all those who sell is clearly not a valid solution if put forward as a complete substitute for the existing systems in multi-point or single-point States, though it may well play a significant role as one of the complementary features of a reorganised system of sales tax.

*Suggestions for a purchase tax*

14. The proposal that States should substitute a purchase tax for their present system of taxation of sales requires more elaborate examination. This suggestion has been made by several representatives of trade and commerce. It has been discussed, as already mentioned, at a conference of officials including State representatives, which was held in Delhi in November 1953. Apart from the claim put forward by some of those who replied to our questions that the purchase tax is a more 'rational' system than the sales tax, the chief

object of the suggestion, in the form in which it is put forward by trade associations, is to solve the difficulties arising from the levy of the tax on non-resident dealers. It is stated that this serious problem would be solved within the existing framework of the Constitution if each State levied a purchase tax on its own dealers and consumers and did not attempt to collect it from dealers resident in other States. For a brief description of the main features of the purchase tax, we invite reference to Chapter I. In considering this tax in connection with the problem of tax levy on non-resident dealers, we have to bear in mind that, for the most part, it is of course the 'importing' State that is interested in a purchase tax because (a) it is within its jurisdiction that the purchase has taken place and (b) under the Constitution, it is the fact of delivery and consumption that gives a State a right to levy the tax. This levy may be either on raw material or finished goods. It may also be on dealer or consumer. So far as the latter is concerned, however, a purchase tax is practicable only in very limited contexts, e.g., purchase of motor cars or other conspicuous and readily detectable articles. A consumer's purchase tax has been adopted by certain States for articles of this kind when bought from dealers of other States; but its limited application makes it a very negligible source of revenue.

#### *Limitations of a purchase tax*

15. The suggestion that the States should levy a purchase tax on their own dealers, who have bought the goods rather than on the non-resident dealers who have sold them, may seem attractive; but it has many serious limitations. Where the non-resident dealer has sold goods to a registered dealer of the consuming State, a sales tax on the goods will later be recovered from the resident registered dealer. The purchase tax is therefore of no advantage from the revenue point of view. At the most it can only assist by enabling a check to be exercised at the purchase end of the resident registered dealer's transactions. Where the non-resident dealer sells to an unregistered dealer or a consumer of the importing State, a purchase tax on the resident unregistered dealer, since he is outside the administrative arrangements for

collection, is *ex hypothesi* impracticable. A purchase tax on the resident consumer has only a limited use as already explained. It follows from the above that a purchase tax on resident registered dealer or consumer is much less attractive from the point of view of the importing State than an extra-territorial sales tax on the non-resident dealer. In the latter case, especially if sufficient cooperation is forthcoming from the Government of the despatching State, it will be possible to collect the tax not only on transactions with resident registered dealers but also with resident unregistered dealers and resident consumers. That is why most States which have assumed such jurisdiction are unwilling to give it up. This applies in particular to States which have little by way of distributive trade within their own territories, e.g., Assam, Bihar or even Madras. These States find it more convenient, and from the revenue point of view more profitable, to go to the non-resident distributive trade situated in places such as Bombay and Calcutta. On the other hand, if we consider the States of Bombay and Bengal, which have large and important sections of distributive trade as well as high and medium grade consumption within their own territories, we find that Bengal is opposed to, and Bombay is not enthusiastic about the expedient of one State Government extending its jurisdiction to dealers of another State and attempting to collect the tax from them. On certain raw materials, for example, Bombay is content to impose a purchase tax at the point at which these are bought by the importing dealer or manufacturer; so far as finished goods are concerned, it imposes the purchase tax more by way of a check at the buying end than as an alternative form of tax. Bengal has refrained not only from taxing non-resident dealers, but also from imposing any purchase taxes.

A further point to be mentioned is that multi-point States such as Madras stand to gain more revenue from collection of the tax on non-resident dealers than by imposing instead a purchase tax on their own dealer. This happens because, if extension of tax power to non-resident dealers is conceded, one more link is added to the multi-point chain of the particular transaction; whereas a purchase tax on the importing or resident dealer cannot be combined with a sales tax on the same

transaction.

Added to these considerations is the difficulty of getting different States with different interests to act in co-ordination for the purpose of enabling the importing State to levy a purchase tax on its own dealers. For, the purchasing cannot be effectively checked unless they are related to the sales by the non-resident dealer. If extra-territorial jurisdiction is not to be exercised, it follows that the Government of the exporting State should volunteer to obtain and supply to that of the consuming State the requisite information from the despatching dealers. This in most cases the exporting State is not prepared to do, for it usually means a great deal of trouble without any commensurate advantage to itself.

For all these reasons, a purchase tax is clearly not an effective solution for the particular difficulties it is supposed to solve.

*Replacement of sales tax by an extension of excise, customs and octroi*

16. Lastly, we may examine the suggestion that the sales tax may well be abolished since the same revenue, with broadly the same incidence, can equally well be secured by an extension of excise, customs and octroi. All goods, it is argued, are either produced in the country or are imported from outside; excise and octroi can be so designed as to secure that requisite additional revenue on the former category and customs can be similarly modified to take care of the latter.

17. Superficially, it may seem that the sales tax is similar to customs, excise or octroi. Judged merely from the point of view of the incidence of the tax on consumers there is arguably not much difference between the sales tax and these other taxes to the extent that they fall on the same commodities. From this is drawn the inference that the sales tax has no distinctive place in the tax structure of the country. This reasoning does not take account of certain fundamental features of the sales tax. It should be clear from the description of the evolution of the tax and the analysis of its features set out in the foregoing chapters that the three main characteristics of the sales tax as it has developed in this country are: (i) a levy which applies or is sought to be applied

to the generality of goods as they reach the stage of consumption, (ii) an incidence which virtually falls in its entirety on the consumer, and (iii) a mode of collection which is almost wholly based on the fixation on the dealer of the responsibility to pay the tax. *In combination*, these three characteristics distinguish the sales tax from excise and octroi. Excise is a tax on goods which are manufactured or produced, and is therefore on production and not on sales or proceeds from sales. A certain amount of confusion arises because at the stage where the goods leave the manufacturer, these two taxes - excise and sales tax - give the impression of overlapping. But the overlapping is only apparent. Excise duties are collected from the manufacturer on his production even if there are no sales, whereas the sales tax is collected only when the manufactured goods are sold. Further, excise duties usually have proximity to the points of production. Moreover, for very good reasons, excise duties are necessarily selective, and therefore the rates of duty are normally high, whereas the sales tax operates at different points of the trade channel, over a larger number of commodities and in varying degrees of proximity to the final consumption and can therefore be levied at comparatively low rates. It also follows that the sales tax can be varied in relation to the different grades of consumers in a manner which is not generally open to excise. In other words, sales tax can take cognizance of the varying degrees of specialisation and differentiation which occur in goods as they leave the stages of production and primary processing with which excise is concerned.

18. Octroi, as a tax at the point of entry into a specialised area, is in many instances unrelated to the different grades of consumption, e.g., goods consumed by the poor and those consumed by the relatively well-to-do classes. It is collected from the consignor, carrier or consignee and not necessarily from the dealer. Besides, it suffers from certain obvious limitations and disadvantages which disqualify it from being considered as a major source of revenue.

19. The third item of taxation mentioned is customs. By themselves it is clear that customs duties cannot replace the sales tax. Many goods that are imported are matched by goods which are produced within the country, and which can presumably be subject to excise duties. But we have already seen that excise duties are difficult to apply to domestic production which is undertaken either on a small or a medium scale; and these form a significant portion of total industrial output. Since, therefore, excise cannot be extended to all domestic industrial goods, whether they match imports or not, and since excise, as mentioned above, cannot extend to all the goods so produced, it is obvious that no combination of excise and customs can yield the same results, in terms of revenue, as a system of sales tax which, through its operation at points nearer the consumer can take all such goods within its purview.

#### *Merits of the sales tax*

20. The merit of the sales tax as a major source of revenue lies in the fact that it is dispersed over a large number of goods and of dealers, and this makes possible the realisation of substantial revenue from a comparatively low rate of tax, whereas, by definition, customs and excise apply only to a strictly limited portion of the industrial output that is sold within the country. Even if the sales tax were levied, not by the States as at present, but by the Central Government on an all-India basis, it would not, in the circumstances mentioned, be a superfluous item in the tax system which could be conveniently and effectively replaced by a combination of excise, customs and octroi.

21. Our analysis of the suggestions made for a change in the present system of sales tax has made it clear that they constitute no solution of the problems created by the working of the sales tax within the context of the existing Constitution. We have not dealt, however, with the suggestion that the sales tax should be removed from the State List and entrusted to the Central Government for administration. To this suggestion as well as the

entire question of the place of the Union *vis-a-vis* the States in regard to the sales tax, we turn in the next chapter.

### CHAPTER IV

#### THE UNION, THE STATES AND THE SALES TAX

##### *Need for a reappraisal of the sales tax problem*

The future of the system of sales taxation in India demands decisions on major issues of policy. The most important of the issues is the place to be accorded in that system to the Union and the States. For a decision to be reached on this issue, there has to be a reappraisal of the problem. The reappraisal must undoubtedly be in terms of the country as a whole, but necessarily also of the country as comprising individual States. If we cannot ignore the effects of the tax beyond the boundaries of individual States - and indeed, as we have seen, the inter-State problems are such as to call for prior attention - neither can we lose sight of the significance of the sales tax for the Government of each State. It is on the basis of this broad consideration that we examine in this chapter, the problem of the sales tax as it emerges from the account already given and as it will be seen in the light of the further facts which will be cited. Also included in this chapter are the conclusions we draw from our examination and the recommendations which we base on those conclusions. It would be convenient to start, in anticipation of our findings, with a concise statement of our assessment on the main problem, then elaborate the analysis on which that assessment is based, sum up our conclusions in some detail and, lastly, set out our recommendations in concrete terms.

##### *Place of the Union and the States in the sales tax system*

2. If our main conclusion may be tersely expressed, it is that the States cannot do without the sales tax and, in terms of two or more States, the sales tax cannot do without the Union. There is in the sales tax system, not only a place for the Union, but an insistent need to give a place to the Union. That place is the whole sphere of inter-State sales. The States' sphere is complementary.

Broadly speaking, it is the whole sphere of intra-State sales as at present. In the absence of more powers for the Union than now vest in it - that is to say in Parliament and in the Central Government - the inter-State sphere of sales taxation is occupied by Constitutional rigidities, occasionally diversified by judicial interpretation, instead of by law and administration that can adapt themselves to changing needs. That law and administration in the inter-State sphere should formally, and when need arises effectively, be with the Union; in actual practice, the administration should, in their individual jurisdictions, be delegated to the States. The revenue, inter-State or intra-State, should wholly devolve on the appropriate States. In the intra-State sphere, the States should be free to develop systems suitable to their varied conditions. There will then be: in each State a system adapted to its own needs, and for the whole of India a composite one in which effective co-ordination will be possible between State and State and between the States and the Union. This then is our main finding compressed into terms of which further explanation is necessary and will in due course be given. Meanwhile we may turn to a somewhat detailed appraisal of the facts themselves.

*Effect of different systems of sales tax on trade and industry*

3. The sales tax has been a subject of complaint by trade and industry ever since its introduction. The grounds of complaint are twofold: first the effects of the sales tax on the trade internal to each State and, to an even greater extent, its effects on inter-State trade. It is, as we have seen, the dealers who are made responsible for payment of the sales tax to Government. The burden of tax compliance, as distinguished from that of tax incidence, is thus avowedly on the trader. The class of traders affected differs for different systems and different States, but one or more classes are always affected. We find, therefore, that whatever may be the system of tax prevailing in a State, there is always, from some section or another of business interests, an agitation against the system in force and a clamour for its replacement by another. In a single-point tax system, where the

importers, manufacturers and wholesalers are not liable to pay the tax and the cost of production of industries is safeguarded by the exclusion of certain essential raw materials, the opposition comes mainly from the retail merchants who, apart from such difficulties as they may experience in passing on the tax to consumers, find themselves obliged to maintain the various accounts required by the administration. There is opposition also from the consumers who directly feel the burden of a high rate of duty. In multi-point States, on the other hand, there is often a demand for a changeover to a single-point tax; this is mainly from the organised sections of trade and industry, i.e., importers, manufacturers and traders who have to pay tax on raw materials and manufactured goods at more than one point. The demand is on the ground that their competitive capacity is affected in comparison with the traders and manufacturers of other States which either do not tax raw materials or tax them, as also manufactured goods, at only one point. Opposition also comes from the trading community at large on the ground that the multi-point tax tends to bring about a reduction in the trade links between the manufacturers and importers on the one side and the retailers on the other, thus causing diminution of business and unemployment. In regard to inter-State trade, the measures, which have been taken by different States subsequent to the Supreme Court's judgement, have made matters worse for traders. With certain exceptions, each State now seeks to recover its tax from the non-resident dealer who delivers goods for consumption within its territory. Traders in distributive centres like Bombay, Calcutta and Delhi find that they have to seek registration under the Sales Tax Acts of practically all States. They are called upon to send returns, submit their books of accounts for examination, be assessed to tax by an officer of each State and make payments in accordance with such assessments. As a consequence, the demand from interests representing trade, industries and commerce sometimes takes the extreme form that the sales tax should be Centrally administered so that the problem of inter-State trade would be solved and complete uniformity assured in the rate of tax, exemptions and procedure and indeed in system generally.

#### *Place of sales tax in the State financial system*

4. While, thus, trade and industry on occasion urge that the sales tax should be centralised, this proposal is strongly opposed by practically all the States. As has been noted, the sales tax now is not only among the largest single sources of revenue to the State Governments, but is also a source which has shown the greatest flexibility in terms of revenue yield. Moreover, the sales tax has become an integral part of the State financial systems, having been in force in some States for as many as ten to fifteen years. The financial structure of the States would be considerably dislocated if, at this late stage, so important and flexible an item of revenue as the sales tax was removed from the State List and transferred to the Union List. The argument that the receipts from the tax can be distributed to the States and their finances not adversely affected, does not take into account the many practical difficulties attendant upon the centralisation of a tax with such strong local moorings as the sales tax. In the rates at which it is levied, whether these be the 'ordinary' rates pertinent to articles in demand by the well-to-do classes, in the different items, sometimes many and sometimes few, that are exempted on general or local grounds or in the context of specific objectives, in the definition and demarcation, by means of prescribed limits of turnover, of those sections of the trade through whom the tax is to be collected - in all these and other important respects, the chief characteristic of the sales tax today is its elasticity as a fiscal instrument: an elasticity which enables State Governments to adapt and modulate it in its application to the widely differing conditions of the different States of India. This elasticity must remain, if the sales tax is to remain. Centralisation of the tax must be ruled out if only on the ground that it is inconsistent with the preservation of this elasticity.

#### *Complexity of sales tax problems*

5. In short, grades of consumption as well as classes of dealers differ greatly from State to State. In the detailed design, as in the operation, of a proper system of sales tax, the capacity of the

consumer to bear the tax and of the dealer to keep the appropriate accounts are matters of great practical importance. Where a State is more rural than urban, the range of consumption which will have to be taxed for ensuring a large enough revenue tends to extend to the interior of the State, i.e., to its smaller towns and even rural areas. For the same reason, the range of distributive trade concerned with the levy and collection of tax tends to extend not only to the medium, but also to the small dealers, who normally would be large in number and widespread in location. Where the tax is related to more urbanised consumption, the pattern of trade, as well as processing and manufacture, will present a series of different problems, strongly localised in character, and therefore varying from State to State; and there will be need for quick and continuous response on the part of the sales tax machinery, including readiness to readjust rules and procedure, in order that the legitimate requirements may be met, as and when they arise, of producer, manufacturer and processor and of commission agent, dealer and consumer. It is true that the coverage of tax-collection extending from urban to semi-urban and rural areas, the number of medium and small dealers actually or potentially included within the spread of the tax jurisdiction and the magnitude and complexity of the difficulties which confront the tax-administration are features which are common to most States. At the same time, they vary considerably in character and composition from State to State and taken together present a large and almost bewildering variety of problems. In face of this, it would be almost impracticable for any departmental agency of the Central Government to administer the tax; and, what is specially important, it would be hardly possible for legislative and rule-making power located in the Central Government to deal effectively and promptly with local grievances which often need to be remedied without delay. Against this background, we are emphatically of the view that the sales tax cannot be transferred from the States to the Central Government.



*National aspects of sales tax*

6. While thus, in our opinion, the tax has to continue to be levied by the States, there are certain aspects of the levy itself which require to be considered from the standpoint of the national economy. The restrictions on the powers of the State Governments to levy sales or purchase tax, imposed under Article 286 of the Constitution, are intended to provide for these aspects. The first of these relates to foreign trade, that is to say, to taxation at the points of import and export and to the need of ensuring that individual State Governments are not in a position to take action that affects the foreign trade of India. The second may be broadly described as the field of inter-State commerce; within this field the need which arises is to ensure that the sales tax system of one State does not impose an arbitrary and unregulated burden on either consumer or dealer of another State or unduly interfere with the free flow of such trade and commerce. The third, as specified in the Constitution, relates to goods essential for the life of the community and in this respect is parallel to the power for their part exercised by the State legislatures and Governments in exempting various categories of goods from the operation of the sales tax within the States.

*Sales tax on foreign trade*

7. In regard to foreign trade, i.e., sales which constitute import and export in terms of the country as a whole, the present position under the Constitution may be regarded as satisfactory. As interpreted by the Supreme Court, this position is briefly that those sales and purchases which themselves occasion the export or import, and those sales in the State which are effected by the importer by transfer of shipping documents while the goods are still beyond the customs frontier are excluded from the sales tax jurisdiction of the States. Purchases in the State by the exporter for the purpose of export and sales in the State by the importer after the goods have crossed the customs frontier are held to be not within the exemption.

Hardly any State has complained about the particular provision of the Constitution which concerns this aspect. We consider the position under the Constitution to be perfectly satisfactory so far as foreign trade is concerned.

*Sales tax on inter-State trade*

8. The provisions relating to inter-State commerce and 'sales outside the State' stand, however, on a different footing. As enacted and interpreted, they have given rise to major complications for the trade and to almost universal protest from the State Governments. Complete exemption of sales outside the State places the exporting State in a disadvantageous position. A State with a backward economy and relying on revenue from the sales tax leviable on its main sources of agricultural or industrial raw materials suffers financially from this restriction. The regulation of sales tax in relation to the effect of the system of one State on the consumer or dealer of another State does not necessarily imply that no tax whatever should be charged on inter-State transactions by the exporting State. What is necessary is to ensure that the tax, if any is charged, should not exceed the limit or limits which Parliament in the interest of the country as a whole considers reasonable and which, accordingly, may have to be embodied in appropriate legislation or regulation. The assumption that control of sales tax in relation to inter-State trade can only be on the basis of eliminating the tax element altogether, in so far as this pertains to a levy by the exporting State, does not seem to us warranted. Unfortunately, this very assumption underlies the relevant constitutional provision; and, as we have seen, it has led to a number of administrative and other complications. In effect, the Constitution lays down that the tax shall go with consumption, and that the exporting State shall not be entitled to levy any part of it. The Supreme Court's interpretation is that the State where the goods are delivered for consumption is entitled to tax the sales of such goods. The constitutional provision, in conjunction with judicial interpretation, and the manner in which the interpretation has been

understood, has virtually brought about the following position: that State alone can levy the tax in which the consumer is situated, but it can collect it not merely from its own dealers but from those of other States. This has had two conspicuous effects. Certain States have been attempting to extend their tax jurisdiction to dealers in other States. At the same time, since such jurisdiction can, in practice, be exercised only over the registered dealers of the other States concerned, it has been found profitable for consumers and unregistered dealers of the tax-collecting State to make purchases from other States. This is only one aspect of the type of evasion which has developed. Even where the consumer or unregistered dealer of the tax-collecting State buys from a registered dealer of the despatching State, the collection of the tax from that registered dealer is obviously a difficult proposition for the State in which the consumer is located. This difficulty could have been surmounted if there was complete co-operation and co-ordination between the two States, i.e., the one in which the registered dealer is situated and the other in which the consumer or unregistered dealer is situated. Such co-ordination can hardly be expected, and in practice has been lacking, for the reason (among others) that the exporting State has no interest in the transaction; it does not get any revenue out of it under the present provisions of the Constitution. The efforts of different States to extend their jurisdiction to dealers of other States, the large volume of evasion which has developed in inter-State trade transactions and the want of co-ordination between States are three important considerations to be kept in mind in deciding whether the exporting State should continue to be denied the power to levy any tax whatsoever on a transaction which results in consumption in another State.

*Effect on inter-State trade of restrictions on sales tax under different systems*

9. This is not all. Another important point to be borne in mind in this context is the difficulty of adopting a line of treatment which is equally applicable to single-point and multi-point systems. In an 'incidence controlled' system, such

as is represented by the single-point scheme of sales taxation, the total tax levied by the States on any one transaction can be readily determined and it is therefore easy to ensure that the whole of the tax is eliminated at the point of sale by the dealer of one State to that of another. In a multi-point system, it is obvious that no such effect can be ensured: the tax collected at all stages except the last, i.e., at all points previous to the ultimate one which results in export to another State, has already accrued to the State Government; its total incidence is not known, because the total number of points at which the multi-point tax has been levied is not readily ascertainable. The constitutional provision, as it has operated in relation to multi-point system, has therefore affected only the ultimate point of sale when the goods are transferred from one State to another. In effect, therefore, multi-point States can retain an appreciable portion of the tax on such transactions in contravention of what may be regarded as the intention of the Constitution. There is no way of altering this position except by altering the multi-point system itself in the States which have adopted it; and that, except in certain respects and to a limited extent, is neither feasible nor, as we shall see later, desirable.

*Effect of restriction on sales tax on essential goods*

10. The third restriction relates to the taxation of "goods declared by Parliament by law to be essential for the life of the community". There is one important distinction in principle between 'essentiality' and 'inter-State trade' as grounds for limiting the relevant powers of the States, that needs to be emphasised. In regard to 'inter-State trade', the Constitutional restriction operates between the Government of one State and the consumers and dealers of another. On the other hand, in regard to 'essentiality', it empowers the Parliament and the Central Government to intervene in the internal tax-system of a particular State. It virtually empowers the Central Government to step in between the Government and the consumers of that State and directs the former either not to tax certain 'essential' commodities or not to exceed a stated level of taxation in respect

of them. This important distinction, together with the conception of 'essentiality' itself has tended to be blurred for various reasons. There is logically no reason why the Central Government should not declare different sets of commodities to be 'essential' to the people of different States. But naturally, the Central Government in this matter thinks almost invariably in all-India terms. As a result, the exercise of the Central power of exemption has tended to concentrate itself on such goods as are of importance in inter-State commerce; and accordingly there has been a significant degree of overlapping between the two logically different concepts of essentiality from the point of view of the life of the community and importance from the point of view of inter-State trade. Besides, the Constitutional provision does not extend to goods on which sales tax had already been imposed by the States at the time the relevant Central Act (under that provision) came into operation. Many commodities, therefore, even of the strictly 'essential' category continue to be taxed by certain States for internal purposes. Yet another fact, which State Governments have brought pointedly to our notice, is that in a few instances (e.g., petrol) the result of applying the 'essentiality' provision has been to put a statutory bar on increasing the sales tax levy on an article without any corresponding restriction as to the duties of customs or excise or both leviable on that article.

*Implications of 'essentiality' in the context of internal trade of a State*

11. It is therefore necessary to examine with some care the implications of the constitutional restriction imposed on the States on the ground of 'essentiality'. Once it is assumed that some restriction in the field of inter-State trade is necessary and should be provided for in the Constitution and further regulated by Central legislation, the issue of 'essentiality', in the context of the Constitutional restriction, resolves itself into the following question: in the purely internal aspect relatable to the interests of the consumers of a particular State, should the Parliament, in addition to the State legislature, have the power to declare that certain goods should be

free of sales tax or be charged not more than a certain rate of sales tax? The answer to this question depends to a large extent on the significance we attach to sales tax in the context of economic policies of national importance. Assuming that no such policy (e.g., statutory price control or price support) is significantly affected by sales tax, and assuming further that the sales tax is not utilised, for example, as a species of internal tariff to create substantial price differentials in favour of one line of production as against another, there is no reason why a State should not determine the range and rates of its sales tax, the incidence of which rests on its resident consumers and the collection of which is made from its resident dealers. In actual fact, there is no reference to national economic policy in the constitutional provisions restricting the power of the State Governments in respect of the sales tax on intra-State transactions. On the other hand, the restrictions rest upon a concept of 'essentiality' which makes no distinction between the 'community' as represented by the people of the particular State and the community as represented by the nation as a whole. In regard to the impact of the sales tax of a particular State on the people of that State, it seems to us unnecessary that the Central Government should exercise, through Parliamentary legislation, a jurisdiction which, in terms of the State's own powers, is at once concurrent and over-riding. There are good reasons why the State legislature and the State Government may be left to decide for themselves the intra-State aspects of their sales tax law and regulation. It is they who will feel the impact of the discontented dealer and consumer, if these latter labour under a legitimate grievance, just as it is also the State Governments that stand to lose revenue on account of exemptions and tax-ceilings. The provision that now exists in the Constitution for the interference of the Central Government in regard to sales tax on intra-State transactions would therefore seem to be inappropriate. This, however, would be subject to the proviso that sales tax on intra-State transactions is not such as to constitute a levy on non-resident consumers. As regards the needs for conformity to national economic policy, this is a matter which not only affects the sales tax but also

many other aspects of fiscal and economic action by the States. The proper way to provide for this would be by way of an appropriate provision for co-ordination between the Central Government and State Governments in the matter of economic development, including therein fiscal policy as but one aspect, and not by a special provision relating only to the sales tax.

*Factors determining the effects of sales tax on intra-State trade*

12. Within the States itself, the effects of the sales tax on trade and industry, and on the consumer, depend on various factors. Among other things, they vary with the system. As already noted, the multi-point system has tended to be adopted by States in which agricultural production and rural consumption are preponderant and small dealers constitute a large section of the trade. In these circumstances, a relatively small levy at each stage can result in appreciable revenue on account of the large number of dealers from whom it is collected and of the large number of goods on which it is levied. The accounts prescribed could be simple, since exemptions would be few or none and the determination of total turnover relatively easy. Trade, industry, and consumers are not much affected so long as the State Government refrains from raising the multi-point rate to a level inconsistent with the main virtues of the system itself. As explained earlier, no multi-point State has in practice refrained from doing so. The higher rates accordingly imposed have, in various degree, affected the trade organisation (by tending to eliminate the intermediate links), raised the cost of production, necessitated exemptions which in turn have complicated the accounts, and, in spite of the exemptions, affected the cost of living of middle-class and other consumers. Certain complications have also arisen through the inclusion of 'luxury' taxation in the multi-point scheme, i.e., in a system which is not really designed for the purpose. All these complications find ample illustration in the working of the system in Madras, Mysore and Travancore-Cochin. In regard to the single-point system, it was fairly satisfactory in the form originally

introduced in different States. By and large, it suited the economic patterns of the States which adopted it. The rate itself (as inherent in this system) was relatively high; but there were liberal exemptions granted so as not to raise unduly the cost of living of the poorer classes. Moreover, the taxable turnover for registration was usually high enough to ensure that only those dealers would be registered who were capable of maintaining detailed accounts in the prescribed forms. Cost of production was not allowed to be unduly affected, this was provided for by the exemption usually granted to the raw materials, as also to a variety of processed goods used in the manufacturing and other industries. But various subsequent steps, taken under the pressure of revenue needs, had the effect of unduly complicating the original system. A few States commenced to tax sales in the course of inter-State trade, and this led to the restrictive provisions of Article 286 being incorporated in the Constitution. The States have reacted to these provisions in various ways. Thus Bihar started taxing both raw materials consumed by its manufacturing and processing industries. Madhya Pradesh levies a tax on certain raw materials which under its original single-point tax were not liable to tax. Bombay, as mentioned before, changed over first to a multi-point and later to a double-point levy; further, it taxes certain varieties of raw materials out of which its industrial concerns manufacture goods, a part of which of course finds its destination outside the State. Even Bengal, notable for the orthodoxy of its single-point system - the tax itself being levied at the last stage - has had to make one significant departure; on account of the evasion of the last-point tax on cigarettes, these have, as we have seen, now been made liable to the tax at the first stage. It is clear, therefore, that no particular system has long retained its original orthodoxy. Circumstances and needs of revenue have compelled the State Governments to make adjustments in the system; the changes have involved some degree of combination of the two systems; but the extent of the combination itself has differed from State to State.

### *Recapitulation of main problems*

13. We may now briefly sum up the relevant facts and considerations as they emerge from the analysis attempted in the foregoing paragraphs. It is broadly correct to assume that the sales tax as it operated in India is collected from the dealer, but is passed on by him as part of the sale price to the consumer. Accordingly, the administrative implications of sales tax are mostly concerned with the dealer and the financial burden of the tax is largely borne by the consumer. Where both dealer and consumer are situated in the same State, the levy of the tax by the Government of that State cannot be open to any objection. It is where either of these is outside the territorial jurisdiction of the State Government that real difficulty is experienced in the operation of the tax. This consideration may be said to underlie one of the main constitutional provisions in respect of the sales tax; in effect, clause (1) of Article 286 links the sales tax to one of the two parties mentioned above, viz., the consumer, and lays down that no State shall levy tax on a sale which results in delivery for consumption in another State. As interpreted by the Supreme Court and, further, as that interpretation has been generally understood, this has resulted in two things:

- (i) State Governments have sought to exercise jurisdiction over dealers resident in other States on the ground that sales by such dealers have resulted in delivery for consumption in the territory of these States; and
- (ii) consumers belonging to particular States have sought to buy direct from dealers resident in other States in order to escape taxation by either State.

It has not been possible to solve the first of these problems by any scheme of co-ordination between the States concerned, because the Government of the exporting State had no fiscal interest in the transaction and was therefore usually not prepared to put itself to the trouble of collecting information for the benefit of the Government of the importing State. The second of these problems assumed serious proportions in certain cases, and the same lack of co-ordination has hitherto prevented a solution. Another main

difficulty is traceable to clause (3) of Article 286 which in effect gives Parliament a power concurrent with that of the State legislature for declaring that certain goods are exempt from sales tax (on the ground that they are 'essential for the life of the community'). Since this provision has not been given retrospective effect, a wide disparity has resulted in the exempted goods of different States; and in a few instances the power of imposing a sales tax ceiling on 'essential' goods has been exercised by the Union with respect to commodities on which it continues itself to levy relatively high duties of customs and excise. Broadly speaking, the only provision of Article 286 which has not given rise to a real problem is sub-clause (b) of clause (1) which prohibits States from levying a tax on sales or purchases which take place "in the course of the import of goods into, or the export of goods out of, the territory of India". Apart from this, the difficulties experienced by trade, etc., and the lack of co-ordination between Governments has been such that there has been from many quarters a demand for transferring the sales tax as a whole to the Union List. But this, as we have already made clear, we regard as wholly impracticable.

### *Consideration of future policy regarding sales tax*

14. In the light of these conclusions, we may proceed to set out certain considerations of policy as basic for the future development of the sales tax. These, in our opinion, are as follows:-

(i) In essence, the sales tax must continue to be a State tax: as a source of revenue (subject to the very minor exception in respect of newspapers) it must wholly belong to the States; and as a tax to be levied and administered, it must substantially pertain to State Governments.

(ii) In broad terms, however, the sphere of power and responsibility of the State may be said to end, and that of the Union to begin, when the sales tax of one State impinges, administratively on the dealers, and fiscally on the consumers, of another State. Broadly, therefore, inter-State sales should be the concern of the Union; so should specific intra-State sales as, for example, when raw material produced in a State is sold to a manufacturer in that State and the finished goods

in turn figure significantly in inter-State commerce. To the extent necessitated by these considerations, but to that extent only, the system should contain the appropriate provisions, including certain constitutional restrictions on the States and certain powers of levy and control by the Union.

(iii) The Constitution in effect divides sales of goods in India into (a) goods delivered for consumption in a particular State and (b) other sales. The dichotomy is imperfect from the point of view of tax administration. On the other hand, all sales of goods could both usefully and effectively be divided into (a) those in the course of inter-State trade and commerce, and (b) those not in the course of such trade and commerce. The former should, broadly speaking, be the sphere of the Union and the latter, the sphere of the States. But the responsibilities pertaining to the Union could be exercised through the State Governments and the revenue in any case be devolved appropriately on them. This would ensure both co-ordination and adaptation to changing needs more effectively than rigid constitutional provision supplemented by occasional judicial interpretation.

(iv) The Union's powers of levy and control in respect of inter-State and specified intra-State sales should be so exercised that

- (a) there is no avoidable duplication in the actual administration of the tax, and
- (b) there is as much incentive for co-ordination as possible between States from which goods are despatched and those in which they are delivered for consumption.

To the extent necessitated by the latter consideration, there is no reason to rule out the levy of a tax at the exporting end of an inter-State sale; such tax, however, should be leviable by the exporting State on the authorisation of the Union and as an agent of the Union; further, its rate would be strictly limited by the Union.

(v) Subject to the above considerations, each State should be free (so far as Central control is concerned) to evolve the system of sales tax best suited to its conditions. Where the State is in effect taxing its own consumer, it should not be open to Parliament to exercise concurrent power

in regard to the declaration of certain articles as exempt from sales tax. All restrictions on the State must be broadly relatable to the 'inter-State' sphere of transactions, i.e., to transactions which may be said to result in 'export' to another State and which, therefore, are important from the point of view of the consumer or industry of another State. The only exception to this would be the raw materials, etc., to which a reference has already been made, since by taxing these (while they are still intra-State) the State Government can effect an increase in the cost of the manufactured article whether such manufacture takes place in the State which produces the raw material, or in another which imports the material from that State; in either case, to the extent that the finished goods are consumed in a State other than the one which taxes the raw material, the increase in cost on account of the tax is a matter of direct concern to the consumer of another State. This, therefore, is an example of an intra-State sales tax having an important inter-State bearing which, on the principles we have mentioned, and provided certain special conditions are satisfied, makes it an appropriate item for control by the Union. It is at the same time imperative that such control over intra-State items of taxation should be strictly confined to a very small number of well-defined commodities of special significance for inter-State trade. Broadly speaking, no commodity should be selected in this context which does not combine the following characteristics: (i) it should be raw material or largely in the nature of raw material; (ii) either as raw material, or later as finished goods based on such material, it should, in terms of volume of inter-State transactions, be of special importance in inter-State trade, and (iii) in terms of the country as a whole, it should also be of special importance from the point of view of the consumer or of industry.

#### *Constitutional amendments for implementing future policy*

15. The recommendations for Constitutional amendment which are set out below in the form of draft amendments are based on the foregoing considerations.

*A. - Seventh Schedule*

(1) In List I, after entry 92, the following new entry shall be inserted, namely:-

"92A. Taxes on the sale or purchase of goods other than newspapers, where such sale or purchase takes place in the course of inter-State trade or commerce."

(2) In List II, for entry 54, the following shall be substituted, namely:-

"54. Taxes on the sale or purchase of goods other than newspapers, subject to the provisions of entry 92A of List I".

*B. - Article 269*

In clause (1), after sub-clause (f), the following sub-clause should be inserted, namely:-

"(g) taxes on the sale or purchase of goods other than newspapers, where such sale or purchase takes place in the course of inter-State trade or commerce".

*C. - Article 286*

(1) In clause (1), the Explanation shall be omitted, and for the words "territory of India", the following shall be substituted, namely:-

"territory of India; or (c) in the course of inter-State trade or commerce".

(2) For clauses (2) and (3), the following clauses shall be substituted, namely:-

"(2) For the purpose of clause (1) of this article, article 269, entry 92A of the Union List, and entry 54 of the State List, Parliament may by law formulate principles for determining whether a sale or purchase of goods takes place in any of the ways mentioned in clause (1) of this article.

"(3) Any law of a State shall, in so far as it imposes, or authorises the imposition of, a tax on the sale or purchase of goods declared by Parliament by law to be of special importance in inter-State trade or commerce, be subject to such restrictions and conditions in regard to the system of levy, rates and other incidents of the tax as Parliament may by law specify".

*Main features of Parliamentary legislation*

16. The Constitutional amendments suggested above provide for Central legislation in respect of all inter-State transactions of sale and certain transactions, whether or not inter-State, in respect of goods which are important in inter-State trade. They also provide for the formulation of principles for determining whether a sale or purchase of goods is within a State or outside it, and whether it is in the course of inter-State trade and commerce or not in the course of such trade and commerce. It is necessary to consider in detail what provisions the proposed Parliamentary legislation should contain in regard to these matters. So far as goods of special importance in inter-State trade are concerned, the Parliamentary legislation will only specify the restrictions and conditions subject to which the States themselves can levy the tax on the intra-State sales transactions. But in regard to inter-State trade in general, it will be for the Central Government to levy and collect the sales tax under Article 269, and distribute the proceeds to the States. It is not envisaged by us that the Central Government would ordinarily maintain any elaborate administrative machinery of their own for this purpose. As almost all the States in India now levy a sales tax and have their own procedure of assessment, collection, etc., and have administrative arrangements for that purpose, it would be both economical to the Central Government and also convenient to the traders who would otherwise be subject to two assessing authorities if the State machinery is used for the levy and collection of this tax. The difference in the system, taxable quantum, etc., would not, for reasons which we explain later, matter much. The Central Government will impose the tax; at the same time, the Parliamentary legislation will have to provide for delegating to the States the powers of the Central Government in respect of assessment, collection, etc. Further, the legislation should provide that the receipts instead of being credited to the Central revenues and then distributed to the States on the basis of collection, should be retained by the States for their own purposes, subject to the exceptions mentioned below.

### *Rate of sales tax on inter-State trade*

17. The proposed Central legislation, for the levy of sales tax on inter-State trade, will have also to specify the rate at which the tax on sales in the course of inter-State trade and commerce should be levied. Since, in permitting the levy of sales tax on inter-State trade, the main intention is to ensure that some revenue accrues to exporting States without raising unduly the burden on consumers in the importing State, it is necessary that the rate to be specified in the Central legislation should be comparatively low. It should, in our opinion, be one per cent, on all articles except on 'goods of special importance in inter-State trade'. Inter-State trade comprises two types of transactions, viz., (i) transactions between registered dealers of one State and registered dealers of another and (ii) transactions between registered dealers of one State and unregistered dealers of another. The rate of one per cent proposed above would apply only to the transactions between the registered dealers in one State and the registered dealers in another. In regard to these transactions, while the exporting States will, under the scheme of Central taxation of such transactions, retain the tax receipts realised from the levy of one per cent, the importing States will be able to recover their own taxes on the re-sales of those goods by the registered dealers within their area.

### *Sales tax on inter-State trade with unregistered dealers and consumers*

18. Where transactions take place between registered dealers in one State and unregistered dealers or consumers in another, this low rate of levy will not be suitable, as it is likely to encourage avoidance of tax on more or less the same scale as the present provisions of Article 286 have done. If this is to be prevented, it is necessary that transactions of this type should be taxable at the same rates which exporting States impose on similar transactions within their own territories. The unregistered dealers and consumers in the importing State will then find themselves unable to secure any advantage over the consumers of locally purchased articles; nor of course will they,

under this system, be able to escape the taxation altogether, as many of them do at present. We further suggest that it should be provided in the Central legislation that when the Central Government levy the tax on these transactions (i.e., inter-State sales between a registered dealer on the one side and an unregistered dealer or consumer on the other side) at the full rates leviable by the exporting State on its internal sales, the proceeds in excess of the receipts from the rate normally leviable on inter-State trade and commerce between registered dealers should be made available to the State where the goods have been delivered. The reason for this suggestion is obvious, viz., that the importing State should have its due share of the tax on these transactions which it will have no opportunity of taxing itself at a subsequent stage. It may, at first sight, appear that the procedure involved in this division of tax receipts will be administratively difficult. It will be necessary first to find out the despatches to unregistered dealers and consumers, secondly, to trace the States where the goods have been delivered; and thirdly, to apportion the receipts among the respective States. It is, however, likely, as observed earlier, that the very fact that the sale of goods to the unregistered dealers and consumers is liable to the full tax on the exporting States would in itself remove any incentive for resorting to transactions of this type. When the full scheme of sales tax proposed by us comes into operation, the extent of trade between the registered dealers of one State and the unregistered dealers or consumers of another will, in all probability, go down to negligible dimensions and the administrative difficulties in apportioning the relevant tax receipts are not likely to be serious.

### *Sales tax on inter-State trade in 'luxury' goods*

19. The Central legislation need make no distinction between ordinary goods and 'luxury' goods on which the State Government for their internal sales may have different rates of taxes. The rate prescribed for inter-State transactions will be uniformly chargeable on all these commodities. Such uniformity in the rate of tax is necessary, as otherwise the 'luxury' goods would



be liable to be charged the higher rates twice over, once in the exporting State and again in the importing State. Lastly, the Central legislation should also provide, with reference to different commodities that where for internal sales no tax (or a lower rate of tax) is levied by the exporting State, the tax to be collected by it on the inter-State sales of the relevant commodities will be similarly exempted (or, as the case may be, taxed at the same lower rate).

*Definition of 'sale' and broad division of powers between the Union and the State*

20. As we envisage it, an important aspect of the Central legislation will be concerned with the definition of the locale of sales for the purpose of defining in detail the relative jurisdictions firstly of the Union and the States and secondly of the States *inter se*. We have elsewhere noted that in the absence of specific legislative provision for these matters, as distinguished from the far too cryptic provisions of the Constitution, on the one hand, and the far too general legal provisions relating to sales of goods on the other, considerable confusion now prevails on important aspects of jurisdiction. Entirely irrespective of constitutional restrictions and Central Government's powers of levy, it is obviously necessary that there should be a body of law which defines, with specific reference to the sales tax, the circumstances in which a sale becomes taxable by a particular State and by no other. The relevant principles can only be formulated after expert examination; we recommend that this should be done and the principles embodied in the suggested legislation. We realise, of course, that the legislation itself may have to be modified from time to time in the light of new circumstances not fully provided for, or of judicial interpretation of the original provisions. Parliamentary legislation as distinguished from constitutional provision, will have the obvious advantage that these modifications can be made as required without undue delay or difficulty. It will not, of course, suffice to define the jurisdiction *inter se* of individual States. The other important aspect of Central legislation would be the definition in adequate detail of what constitutes a sale or purchase in the

course of inter-State trade or commerce. In this matter too, the embodiment of the principles in an enactment of Parliament, and not in the Constitution itself, would have the advantage that the details of the law can, without undue rigidity, be modified to suit new facts or unforeseen circumstances. As we have stated, the Constitution itself would of course lay down the broad division of tax power between the Union and the States. The important fact would remain that all sales would fall under one or the other of these categories. The Union, which under the scheme would, of course, derive no revenue from the taxation of inter-State sales or purchases, would be solely interested, in the legislation which it promotes, in securing, from a practical angle, the maximum possible co-ordination between different States in regard to the operation of the inter-State sales tax and the maximum possible equity in the apportionment of the relevant proceeds to the States in which the goods have been physically delivered and those from which the physical despatch has taken place. In the actual provisions of the law, it will no doubt avoid the many pitfalls which have been a feature of the present constitutional provisions as they have been interpreted and implemented, and even if it does not fully succeed in doing so at the outset, the relevant legislation, as we have emphasized, can be modified at subsequent stages in conformity with the administrative and other requirements as they arise from time to time.

*Provisions of Central legislation*

21. To give effect to our recommendations regarding the Central regulation of States' sales taxes on goods of special importance in inter-State trade, the Central legislation will have, firstly, to specify such goods, and secondly, to impose conditions and restrictions subject to which the State Governments can impose their tax on the internal trade in those goods. The main condition will be that no State shall have a system of levy other than a single-point levy on such specified goods. The tax may either be on sales or on purchases, but it will be recoverable only at the last stage of sale or purchase by a registered dealer. This condition is necessary to ensure that

the tax burden on goods of importance in inter-State is properly regulated and not allowed to remain vague or undetermined as would be the case under any other system of sales tax. The second condition will be to prescribe the maximum rate of tax. As stated earlier, we recommend that this rate should be three pies per rupee. This would amount to nearly  $1\frac{1}{2}$  per cent as against the

one per cent which we have recommended in respect of all other inter-State sales. There are two important grounds on which we recommend this higher rate. Firstly, for the goods specified as of special importance in inter-State trade, as distinguished from all other goods which figure in inter-State trade, the point of levy of the tax will be only one, i.e., the point at which such goods (raw material, etc.) are taxed by the State in which they are produced. As we proceed to mention below, it will be a condition in respect of such goods that no other sales tax shall be levied on them either by the exporting State or the importing State. Secondly, the higher levy we recommend will be at the raw material or analogous stage when the cost of the goods will obviously be much lower than at the subsequent stage of the conversion of the material into finished goods. A levy of  $1\frac{1}{2}$  per cent at the earlier stage would, therefore,

by no means be unreasonable in comparison with a levy of one per cent on manufactured goods. A tax at this rate will ordinarily be levied either at the point of despatch of the specified goods to another State or when the raw material, etc., are sold in the producing State itself, for manufacture in that State, at the point of sale to, or purchase by, the manufacturer. The third condition, as already indicated, will be that the importing State should not levy either a sales tax or a purchase tax on these goods if at the export end they have already been subjected to tax; otherwise these commodities would be taxed more than once and the object of controlling the incidence thereon will be frustrated. All these conditions are accordingly necessary, if the burden of tax incidence on these selected commodities of all-India importance is to be properly controlled in the light of the principles we have enunciated.

### *Main features of Central legislation*

22. The points for Central legislation may now be briefly enumerated:

(1) The Central legislation to be enacted under the powers proposed to be given to the Central Government should, as its principal feature, authorise the State Governments to impose on behalf of the Central Government a tax on the sale or purchase of goods in the course of inter-State trade and commerce. The Central legislation should also delegate to the State the Central government's powers to levy and collect the tax, and for this purpose prescribe the same system of registration, assessment, etc., as prevails in the States concerned under their own sales tax system. It may also impose conditions regarding the collection of this tax and take powers to compel any State to collect the tax on behalf of the Central Government.

(2) The rate of tax to be prescribed under the Central legislation should be

(a) For inter-State trade between registered dealers:-

(i)  $\frac{1}{4}$  anna in the rupee for "specified goods", and

(ii) one per cent in regard to all other goods.

(b) For inter-State trade between a registered dealer in one State and an unregistered dealer or consumer in another:-

the same rates as are levied by the State (from where the goods are despatched) on sales or purchases of similar goods within its territory.

No distinction should be made for the purpose of this Central tax between a State adopting a single-point sales tax and a State which has either a multi-point or two-point sales tax.

(3) The receipts from the imposition of the proposed Central tax on inter-State trade between a registered dealer in one State and a registered dealer in another should be retained entirely by the State levying the tax on behalf of the Central Government. But in regard to the receipts from the imposition of the tax [referred to in 2(b) above] on inter-State trade between a registered dealer in one State and an unregistered dealer or consumer

in another, the State imposing it on behalf of the Central Government should retain only such portion of it as represents receipts from the tax at the rates fixed for inter-State trade between registered dealers [vide 2(a) above] and make over the excess receipts, if any, to the States which have received the goods in the course of such trade. This is necessary: firstly, to prevent the avoidance of sales tax by dealers through inter-State trade with unregistered dealers and consumers; and, secondly, to ensure that a part of the receipts from the tax on such transactions also accrues to the States to which the goods have been sent.

(4) The Central legislation should also provide that:

- (a) there will be no levy of the Central tax on the sales or purchases of goods in the course of inter-State trade and commerce, if the same are exempted within the State from a sale or purchase tax of the State concerned. Similarly, if for internal trade, any goods are liable to a lower rate of tax than that prescribed for the Central tax on inter-State trade, then the Central tax will be leviable only at the corresponding lower rate;
- (b) no purchase tax will be levied by the State on the specified goods on which a Central tax on inter-State trade has already been levied at the rate of 1/4 anna in the rupee.

(5) The Central legislation should embody principles for determining whether a sale or purchase of goods takes place: (i) outside the State; (ii) outside the territory of India; and (iii) in the course of inter-State trade and commerce.

(6) Subject to the limitations mentioned below, the States should have full powers to tax sales or purchases of goods, including goods declared at present as essential for the life of the community under Article 286 (3). In regard to the levy of a tax by the States on sales or purchases of 'specified goods', the Central Government should take power to impose conditions subject to which the States can levy the tax. These conditions should be that, in replacement where necessary of existing systems and levies,

- (i) the States shall levy only a single-point tax (at the last stage of sale or purchase) on these goods, and

- (ii) the rate shall not exceed 1/4 anna in the rupee, i.e., the same rate at which the Central tax will be imposed on these goods in the course of inter-State trade.

The following goods should be specified in the Central legislation:-

- (i) coal;
- (ii) iron and steel;
- (iii) cotton;
- (iv) hides and skins;
- (v) oilseeds;
- (vi) jute.

We would emphasize that this list should not be extended except in the light of the principles we have elsewhere mentioned; we would further strongly recommend that no addition should be made to this list without consulting the Inter-State Taxation Council, for the establishment of which proposals are made in another part of our Report.

## CHAPTER V

### THE STATES AND THE SALES TAX

#### *Future pattern of sales tax*

In this chapter we propose to explain a little further the considerations underlying the pattern of sales tax we have recommended for individual States: an adaptable pattern which, while combining some of the features of the principal systems, multi-point and single-point, provides for the correlation of those features to the conditions of the particular State, especially those relevant to the structure of its trade, consumption and production. We also propose to consider in some detail the problems which arise in the administration of the tax by State Governments.

2. In view of the need for additional revenue for developmental and social welfare activities the tax system has to be so fashioned that as many people as possible contribute to the exchequer in accordance with their individual capacities. A general sales tax is one of the means available for ensuring this. If the tax is to reach the lower income groups and cover a large number of persons, the rate of tax has to be low and the system (in this context) a multi-point one. Though it is on the consumers that the burden of the tax may be expected to fall, it is on the dealers that the responsibility for payment will rest and,

where the coverage of the tax is wide, the large majority of these will obviously be small dealers operating in the semi-urban and rural areas. For them, the maintenance of complicated accounts and the assessment of liability on the basis of those accounts will present difficulties which are more burdensome than the amount of the tax itself. The requirements of tax compliance, therefore, have to be simplified and otherwise adapted to their capacity. Exemptions, however well-intentioned, add to the burden of compliance, since separate accounts have to be kept of all the sales exempted. It will be simpler for the small trader to calculate his total gross turnover for a year and pay the tax at the rate prescribed. To State Governments too, the extension of the tax liability to the total turnover of the dealers would be advantageous from the point of view of revenue; the coverage will be wide not only in point of dealers, but also in point of goods. The low rate at which any such tax can be levied will prevent any undue rise in the cost of living of the poorer classes. The rates now imposed in most of the multi-point States will be readily seen to be unsuitable for wide-based multi-point tax recommended here, especially when it is remembered that it is part of our recommendation that for dealers at a higher level of turnover, this tax should be combined with a single-point tax. Where the latter is nine pies in the rupee as in Bengal for example (or, in the shape of a double-point tax, is in effect nine pies in the rupee as in Bombay), and even where the single-point tax is half an anna in the rupee, we are of the view that the concurrent multi-point tax which we recommend should not be higher than half per cent. We should be understood as saying this without prejudice to the possibility of Bengal and Bombay reducing their present rates of tax, single-point or double-point, in the event of their adopting the additional multi-point tax here recommended. Moreover, in the context of the combined system we envisage, we consider that, irrespective of the level of the single-point rate which may be adopted, the concurrent multi-point rate cannot be anywhere near as high as one and a half per cent, which, in the separate context of their present system, now obtains in Madras and certain other multi-point States. In other words,

we envisage the future system in the multi-point States as one where there is a substantial reduction in the rates of the multi-point tax accompanied by the introduction of a single-point tax at appropriate rates and with appropriate exemptions from the single-point levy. In the single-point States, we envisage the future system as one where the single-point tax continues to prevail with appropriate exemptions and at appropriate rates (i.e., rates appropriate to the combined system) but accompanied by a multi-point tax at substantially low rates, and with hardly any exemption, as recommended by us. We would stress these considerations regarding rates and exemptions as an important part of the assumptions underlying our recommendations for a flexible pattern of sales tax for the States as a whole. We recognise that it will take some time before State governments are able to effect the changes necessary to bring their existing systems in line with the pattern recommended by us. Obviously, the pace of change and the length of the transitional period will have to be related by State Governments to their individual circumstances. We trust, however, that the pace will not be unduly slow or the period unduly long.

3. All dealers having a turnover of Rs 5,000 a year may be made liable to the multi-point tax in the combined system we recommend. We have already indicated that an exception should be made in favour of agriculturists who grow and sell their own produce. It is possible that when the taxable quantum is brought down to Rs 5,000 a year, there will be some traders who will not be able to maintain even the elementary accounts which will then be ordinarily required. For such dealers, there should be a scheme of composition under which the liability to tax is assessed on the basis of the purchases made; some States have schemes of this kind even at present. The returns and forms to be prescribed for this wide-based multi-point tax will necessarily have to be simple and easily understandable.

#### *Rates of tax*

4. A low rate of multi-point tax of the type proposed by us will secure the object of making low-income groups contribute to the exchequer

according to their capacity; by itself, of course, it will not constitute an adequate system of sales tax for any State. The present rates of sales taxes on ordinary goods vary from six to nine pies in the rupee. For these States, a tax at the rate of half per cent or roughly a pie in the rupee is not going to yield the existing revenue derived by them at these higher rates, even though the taxable quantum of turnover will be lower and the exemptions withdrawn. Secondly, a low rate of half per cent on all goods would leave the higher income groups comparatively unaffected. To this extent, the sales tax system will be inequitable and discriminatory in favour of the middle and higher income groups. For both these reasons, a tax at a higher rate on traders in organised business and on goods other than those consumed by the common man is essential. The best method of levying a tax at a higher rate is under a single-point system, with the point of levy, ordinarily, at the last stage of sale. If the taxable quantum is fixed at a relatively high limit, say Rs 30,000 a year, (there will of course have to be slight variations of this for different States) the dealers liable to this tax will largely be from urban areas and of a class that will be better able to maintain accounts than the petty dealers whose obligations will not extend to beyond the proposed multi-point levy. The single-point tax at the last stage of sale will, as we have already stated, be in addition to the multi-point tax and the taxable quantum of the dealers liable to this tax will have to be determined by each State in accordance with its revenue requirements and other circumstances after taking into consideration the likely realisations from the basic multi-point tax. The higher rate of the single-point tax will apply to goods other than those entering the cost of living of the poorer classes. As the dealers liable to this tax will be those above a relatively high turnover limit, they should not ordinarily experience difficulty in maintaining detailed accounts of total sales, sales to registered dealers, sales of exempted goods, etc. The single-point levy need not necessarily be uniform on all types of goods. As at present, some of the 'luxury' articles can and should be subjected to higher rates of levy. There are however some States which do not make any distinction between ordinary and 'luxury'

articles. We suggest that these States impose higher rates of tax on 'luxury' goods. We also suggest that States which have already enforced such differential rates should enlarge their list of luxury articles.

#### *Exemptions from tax*

5. Certain articles will of course have to be exempted from the single-point tax. Each State will have to determine its own list of exemptions on the basis of its revenue needs and of the economic conditions, social habits, etc., of its people. Only some broad principles can be indicated. The most important exemption, so far as the single-point part of the system is concerned, would be foodgrains. The low-income groups spend a very large percentage of their incomes upon food and they would already be paying the multi-point tax on this under the proposed system. Secondly, such exemption has the advantage of minimising the effect of discrimination in favour of agriculturists who grow their own foodgrains and are not treated as dealers liable to tax. In addition to the exemption of foodgrains, some States exempt necessities like vegetables, fruit, milk, kerosene, fuel, etc. Other types of exemptions are related to educational purposes, or are given for the purpose of encouraging co-operatives, cottage and village industries, agricultural production, etc. While the objects with which exemptions are granted are laudable, each exemption reduces revenue and to that extent may necessitate an increase in the rate of tax on other goods. It also widens the scope for evasion. There is, therefore, good reason for limiting the exemptions to a few large and well-defined classes of goods. Generally, the exemptions under the single-point system should be confined to commodities which figure substantially in the cost of living of the poorer sections. To this general rule, an exception has to be made in the case of raw materials sold by the producers themselves. This is necessary partly for administrative reasons (especially where the producers are individually small and together very large in number) and partly in order to ensure that the final products do not bear an unduly heavy burden of tax, once at the raw material stage and again at

the stage of finished goods. Apart from this, sales tax concessions are hardly a suitable method of encouraging particular industries, trades, activities, etc. Even where such encouragement through concession is deemed to be both essential and in conformity with national economic policies, care should be taken to ensure that exemption does not lead to evasion or abuse. Exemption of products of cottage industries like handloom woven cloth may be provided for only in the context of their sale by the producers themselves or their organisations, as a general exemption in favour of these creates difficulties for the trader and for the administration and very often results in the misuse of the concession. Exemptions which are vague or undefined, or are liable to be interpreted in more than one way, are always a source of harassment to the traders and lead to corruption of the officials. It is necessary, therefore, that the exemptions should be expressed in terms of well-defined categories of goods which both the trade and the administration can readily understand. The lists of exemptions of several States contain items which are related to the prices of the commodities; i.e., the exemption becomes operative only when an article belonging to the general category is sold at below a specified price. This adds to the confusion, occasions complications in accounts, and thus often results in evasion of the tax. As assessments are usually made by the Sales Tax Department more than a year after the close of the period to which they relate, it is difficult to determine whether the sales for which exemption is claimed were really of the types provided for in the exemption list. States should therefore desist from notifying exemptions of this kind. This observation applies to all exemptions which, while serving very little purpose in themselves, add to the cumulative inconvenience and harassment of the dealer.

#### *Financial effects of proposal*

6. One effect of the above scheme, i.e., a basic multi-point tax of half per cent with a single-point tax on higher turnovers at rates suitable to the various States, should be an increase in the sales tax revenue of State Governments. For the States

which at present levy a single-point tax, the realisations from the basic multi-point tax will be an addition to their present revenue from their tax. The States which at present levy a multi-point tax will however have to reduce their present rate of tax to a suitable level, but their loss from this reduction in rate will, we believe, be more than made up by (i) the additional single-point levy on turnovers (including higher rates on 'luxury' articles) and (ii) the extension of their multi-point tax to dealers with turnovers much below their present level and to sales of all goods without exception. For Bombay, which is a rather special case with its two-point tax, one of the implications is that its present levy of three pies in the rupee at the first stage of sale has to be replaced by the proposed basic multi-point tax at half per cent. The turnover limit prescribed at present in Bombay is Rs 25,000. Under the basic multi-point system, this limit will be reduced to Rs 5,000. The decrease in revenue consequent on foregoing the first-stage tax of three pies in the rupee will, we believe, be more than made up from the multi-point tax at all stages of sales of all goods by dealers having annual turnovers over Rs 5,000. The last point levy and the 'luxury' tax rates will, unless the State Government takes a decision to the contrary, remain unaffected. On our estimation of the possibilities, therefore, the adoption of the flexible pattern recommended by us will mean that every State will gain in revenue, in addition to achieving a simpler and more rational system for the different classes of its dealers. Over and above this, there will be the gain from that part of the proceeds out of the Central tax on inter-State transactions which each State will get under the proposals we have made. Finally, there is the financial gain accruing from the substantial reduction which we believe will be effected, as a result of these proposals, in the very considerable evasion which now takes place in inter-State trade.

#### *Advantages of proposed scheme of sales tax*

7. The adoption of the scheme suggested above by the different States, will make it unnecessary for them to resort to the taxation of non-resident dealers, as they do at present on the basis of the

interpretation they place on the Supreme Court's ruling in respect of Article 286. The difficulties created by these attempts of different States to tax non-resident dealers have already been explained. We have also indicated how a purchase tax on resident dealers, in place of a sales tax on non-resident dealers, will not meet the objectives underlying the incorporation of Article 286 in the Constitution. In the event of our recommendations being accepted, it would be imperative that the States do not attempt either to tax non-resident dealers or to introduce a purchase tax even during the interim period, i.e., during the time taken to carry out the necessary Constitutional and legislative measures for implementing the scheme proposed by us. We would urge the desirability of the different States maintaining, in regard to their sales tax levies on inter-State transactions, the position which prevailed before the Supreme Court gave its judgement on Article 286. This view would apply even with greater force to action taken or contemplated to recover tax on sales by non-resident dealers even during the period prior to the date of coming into force of the Constitution on the ground that the then existing provisions of their sales tax laws entitled them to make such a levy. Whatever the legal justification of this course, it will, in our opinion, be unfair to recover sales tax on old transactions on which according to the then prevalent system no tax was claimed and presumably no additional payment was realised from consumers at the time of sale. It will be appropriate, we suggest, for State Governments to desist from such action against non-resident dealers, and thereby to facilitate the speedy implementation of the scheme proposed by us.

#### *Administration of sales tax*

8. We may now turn to the administration of the sales tax. It is true that all taxes are unwelcome and that no tax can be rendered popular by good administration; but few taxes can be rendered so unpopular by bad administration as the sales tax. The point has to be firmly grasped that a sales tax system which is avoidably unwelcome is to that extent avoidably inefficient. The sales taxes of different States can be rendered less unwelcome

in proportion as legislation is less ambiguous, regulation less complex, assessment less dilatory and, in more general terms, administration at various points less open to the charges of inefficiency and corruption. We are convinced that a considerable part of the position of the trade and industry to the sales tax levies in every State is a result of the methods of administering the tax. We cannot wholly discount the allegations made to us in several States that there was corruption in the administration of the tax or that evasion was on the increase; and we have evidence to show that assessments have not been prompt and that arrears are on the whole mounting. It is perhaps hardly necessary for us to point out: firstly, that corruption penalises the honest person and tends to demoralise him; secondly, that the person who pays the sales tax is, by and large, the trader; and thirdly that in this class, as indeed among others, the honesty that is present needs careful nurture, rather than persistent discouragement, even if only in the interests of the exchequer. It is imperative, therefore, that prompt and vigorous steps should be taken to uproot corruption in the administration of the sales tax. One of the main roots of that corruption is in the complexities of enforcement and the desire on the part of the traders to seek escape from these. Unless, therefore, rules and procedure are understandable, unambiguous and capable of easy compliance, it will be difficult either to reduce malpractices and corruption or to increase the efficiency of the Sales Tax Departments. We have indicated in the earlier chapters how States which began with a simple system of either a multi-point or a single-point tax, have later, on revenue considerations, made their systems unduly complicated by the incorporation of new and complex features, and how all this has added to the difficulties of both traders and administration and resulted in much evasion and large arrears, besides general demoralisation among those affected. We believe the adoption of the pattern we have recommended will result in reducing, from the point of view of the specific classes of dealers concerned, and therefore for administration generally, many of the complexities which now beset the sales tax systems of

different States. It is nevertheless necessary to consider specific problems and difficulties in some detail.

#### *Regulation under sales tax laws*

9. The items to be considered may be broadly classified as relating to (i) regulation and (ii) administration. Not all the requirements of tax collection are mentioned in the Act imposing the tax. Some of them are specified in the Rules framed under the Act. In some States, many substantive provisions which ordinarily should have been included in the Act find a place in the Rules. Most of the Acts provide for prior publication of draft rules and amendments of rules so that public criticism may be taken into account before their promulgation. There have, however, been complaints that the time allowed to trade, industry and the public to study the modifications proposed from time to time is often inadequate. Complaints have also been made that changes in the Rules are frequent and are made before trade has had time to adjust itself to new requirements. We bring this to the notice of State Governments.

#### *Items of regulations*

10. Some of the basic items of regulation concern (a) registration or licensing of dealers, (b) procedure relating to exemptions, (c) maintenance of accounts, and (d) submission of returns and payment of tax. Whatever the system of sales tax, all dealers liable to the tax are registered. Under the multi-point tax, the registration ensures a certain degree of control over the dealer, while under the single-point tax it also helps to determine the point of tax liability. The procedure relating to exemptions, however, is more difficult. In the single-point system, the requirements to be complied with are more than in a multi-point system. Exemptions of sales to registered dealers require the maintenance and the production of proof to show that the sales are, in fact, to registered dealers. Similarly, exemptions of sales of goods despatched to addresses outside a State require the production of evidence to show that goods have actually been despatched and delivered outside the State. Sales of goods exempted

under the Act or under the Rules also involve the keeping of elaborate accounts, proofs, etc., for satisfying the assessing authorities about the *bona fide* character of such transactions. Every registered dealer has to maintain his accounts and other documents relating to his business in a satisfactory manner for the inspection of the assessing authorities. Where these are not so kept, the Act gives power to the authorities to prescribe the form in which they should be maintained. Further, the account books and other records have to be preserved till the assessments are completed. Some States have assumed power to call upon dealers other than registered dealers to maintain proper accounts. The submission of returns and the payment of tax have to be made periodically. The returns require the separate classification of turnovers of different categories, e.g., sales to registered dealers (in single-point system), sales of exempted goods, sales of goods despatched outside the State, sales of goods liable to different rates of tax, etc.

#### *Difficulties of trade and industry*

11. In regard to these requirements, the complaints of the trade and industry centre round exemptions, accounts and returns. A valid difficulty, to which our attention has been drawn in many States, arises from the loose and often ambiguous language in which some of the exemptions are couched. Much hardship, it is pointed out, is caused when a *bona fide* interpretation by the dealer is later challenged by the taxing authorities. Also, there are exemptions which are conditional on the sales being for certain purposes, or their being only to certain classes of buyers and so on. These increase the difficulties of the dealer who often finds himself in the position of having to pay the tax on sales on which he had not himself recovered any tax. It is necessary that exemptions should be definite in scope and not dependent on conditions which require elaborate proof. We have already referred to this point and would stress it again in the context of eliminating from the tax all such features as unduly or unnecessarily add to the burden of tax compliance. When a dealer is taxed on all his sales, the keeping of accounts for



assessment of tax is comparatively simple; but when some sales of goods are taxable and others are not, the keeping of accounts and the submission of returns present difficulties which may be administratively unavoidable, but which, by the same token, administration ought to keep to the absolute minimum. The same observation applies to the requirements connected with 'luxury' goods on which higher rates of taxes are levied.

12. The complexity of accounts is one of the main grievances of the dealer. Difficulties arise even in multi-point systems, as when the tax is levied at different rates on luxury goods or is imposed at only some stages, and not at others, on some goods. The complaints we have received from the smaller traders seem to us particularly valid. The State Governments have generally recognised these difficulties. They have, for example, refrained from prescribing specific forms of accounts for purposes of the sales tax and have allowed dealers to adhere to their own methods of keeping accounts. For small traders, many States have provided a scheme of composition under which the assessment of tax is made on the basis of documents relating to purchases, etc. In regard to the submission of returns and payment of tax, these have, in most States, to be made every quarter, though in some States they have to be made monthly. Such frequent submissions become an unnecessary burden on dealers whose business consists mainly of exempted goods. While, therefore, too long a period for all dealers would not be advisable as it may lead to evasion of tax on a larger scale, an exception can be made in the case of the smaller dealers. Further, a half-yearly period for submitting returns and for payment of tax would be more suitable for this class of dealers.

#### *Aspects of administration*

13. Passing on from regulatory provisions to specific aspects of administration, we have to consider the Sales Tax Organisation in relation to the following aspects:-

- (i) administrative powers of the taxing authorities;
- (ii) assessment;
- (iii) inspection;
- (iv) supply of information; issue of rulings, interpretations, etc.; and
- (v) behaviour towards the public.

The administrative powers of the Sales Tax authorities include those of discretionary assessment where the returns of dealers are incorrect or where no returns have been submitted, of compelling dealers to produce their books of accounts, of inspecting them at the premises of the dealers, of seizing them where they suspect the dealer of evading the tax and of searching the premises of the dealers for books of accounts, etc. The Sales Tax Acts also empower the Collector or Commissioner of Sales Tax (Commercial Taxes in certain States) to determine certain disputes such as whether a particular dealer is liable to registration, whether any particular sale is taxable, etc. The Sales Tax Authorities enjoy, in certain respects, wider powers than the Income-Tax Authorities. It is obvious that powers of this kind, most of which can be abused and many of which can result in needless harassment unless exercised with restraint, should be vested only in officers of adequate seniority and rank. Fortunately, the State Governments are aware of the dangers of delegating wide powers to subordinate officers of the Sales Tax Department and the complaints made to us in this respect are not many. We need hardly stress the need for vigilant watch by the higher authorities over the exercise of these powers.

#### *Delays in assessment*

14. As indicated earlier, assessment is in arrears in most States. While the delays are partly due to the numerous adjustments and modifications made in the sales tax systems, they are, in some States, traceable to the inadequacy of the staff

itself. Unless the dealers are assessed promptly within a short period after the close of the year, they are put to much inconvenience. Sometimes points of dispute arise and, in order to settle them, various types of evidence and attestation may be required: e.g., declaration certificates of purchases made, supplementary documents regarding sales and so on. The greater the delay in assessment, the more troublesome and intractable are the disputed items from the point of view of both dealer and administration. If, as is sometimes the case, the assessments are delayed over a number of years, it is impossible for the dealer to obtain the necessary evidence, documentary and other. While the honest dealer thus suffers, the delay helps the dishonest dealer in many ways, e.g., by giving him time to shift his place of business or to disappear from the State altogether. One more point may be mentioned. The collection of outstanding amounts, e.g., those based on the final assessment, would be easy if this is done shortly after the close of the year; otherwise, in many cases they would not be recovered at all in spite of the legal provision that arrears of sales tax may be recovered as arrears of land revenue. To the extent that, in certain States, the heavy arrears in assessment are due to inadequate staff, it is necessary that the establishment should be strengthened. Apart from other considerations, since the Sales Tax is a major source of revenue, any false economy in this matter will be positively harmful to the public interest.

#### *Need for inspection and investigation*

15. While on the one hand assessment has lagged behind, inspection and investigation have not received the attention which they should. In many States, the same staff is expected to do both assessment and inspection and the latter is either not done at all or indifferently done; in a few States - though even in these not to an adequate extent - the Sales Tax authorities do pay surprise

visits to dealers' premises, make confidential enquiries about dealers' turnovers and investigate the purchases and sales of one dealer by reference to the returns and documents submitted by other dealers. In certain countries, the two functions are treated as distinct and the inspecting staff is different from the assessing staff. In Canada, for instance, the inspecting officer also acts as a liaison man with the dealers in the area, calling on them, answering their questions and showing them how to keep documents according to the requirements of the administration. This is an aspect of Sales Tax administration which in India still awaits development. The maintenance of a separate inspection staff to detect evasion and find out the evading dealers and also to serve as a liaison between the department and the dealers is extremely desirable. This would reduce evasion and help the dealers to comply better and more promptly with the requirements of the administration.

#### *Creation of intelligence section*

16. There is a good case for the creating of an Intelligence Section in every Sales Tax Department. The duties of this section would include the maintenance of necessary statistics, e.g., about the pattern of trade and consumption in the State on the basis of the sales tax returns received by the Department. Detailed information about the different types of traders in the State, classification of tax receipts according to realisations from sales of different goods in the State and outside the State, etc., would be of great value to the State Governments in determining their tax policy, list of exemptions, etc. The Intelligence Section could also help in checking evasion by obtaining relevant information from the Railways, Central Excise, Income-tax and similar authorities of the Union Government about the business of the dealers liable to the sales tax.

*Wider publication of rulings and instructions of Sales Tax Departments*

17. In administering the provisions of the Sales Tax Acts and Rules, the Sales Tax Department has on several occasions to give opinions as to the leviability of tax on a particular sale or on a particular class of dealer, to specify the elements of proof required in certain contexts and so on. The opinions are expressed in response to the trading community in general. The work of dealers and of the Sales Tax Department as well will be facilitated if such rulings and instructions are published at regular intervals for the information of those concerned. The provisions of the Act and the Rules, clothed as they invariably are in legal form of language, are not clear to a majority of dealers. For the information of these, it is the duty of the Sales Tax Department to issue small pamphlets (if necessary as priced publications) in regional languages, setting out in clear and readily understood terms the variation of tax liability, the classes of exemptions, the contexts in which higher levies are made, the broad particulars of procedure connected with the filling in of returns and payment of tax, and so on. Associations of traders sometimes issue pamphlets for the information of their members. But there is considerable need for authoritative pamphlets on procedures being published by the State Governments themselves.

*Behaviour towards public*

18. The behaviour of sales tax officers, inspectors and staff towards assesseees and the public is a matter of great importance. While some of these are tactful and courteous in their dealing with traders and others, there are several who have yet to learn the lessons of polite behaviour. Firmness in securing the interests of the public revenue does not consist in downright disbelief of the dealer's statements, inquisitorial investigation of odds and ends in his accounts and, in general, an attitude of determined discourtesy

towards the assessee. Appreciation of the *bona fide* difficulties of traders, guidance in proper compliance with the requirements of the tax administration and courteous behaviour are certain to go a long way towards making the sales tax departments less unpopular than they are at present.

*Issue of cash memos and vouchers*

19. Before passing on to evasion in a few of its more detailed aspects, we may refer to one specific problem which in some ways is connected with evasion. The consumer, as we have seen, is concerned with the burden of the tax; he is also anxious that the dealer does not cheat him by charging more than the proper tax. Most State Governments have therefore provided in their Acts and Rules that, where cash memos or vouchers are issued, the price and the tax should be separately shown and the latter limited to what is actually payable by the dealer. If more is charged than due by way of tax, or if a tax is charged when none is leviable, the dealer is liable to be prosecuted. As a corollary, unregistered dealers from whom the tax is not collected by Government are prohibited from indicating a tax element in their vouchers. The position, however, is full of anomalies. For obvious reason, no State Act lays down that the sales tax should be passed on by the dealer to the consumer. It is the dealer on whom the tax is levied and, strictly speaking, it is his own business whether or not, and by how much, he increases his sale price on this account. Nevertheless, State Governments tacitly accept the practice whereby registered dealers purport to charge their customers separate amounts as sales tax. Where dealer and buyer do not collude, the buyer suspects evasion on the part of the dealer if the latter omits mention of sales tax in the voucher, and the dealer for his part is often anxious, through specification of tax in the bill, to point out in effect to his customers that they are being mulcted by Government and not by him, so far as that particular amount is concerned. This

method of satisfying the customers is however rather unfairly denied to the unregistered retailer who, all the same, has to pay the tax on his purchases from registered wholesalers, and sell the goods at more or less the same price as the registered retailer. Moreover, the practice of showing the tax separately in bills leads to the customer bargaining for his not having to pay it, and to the dealer offering not to charge it provided a voucher is not insisted on, the result being collusion and evasion. It seems to us desirable, in these circumstances, that separate mention of the tax in the bill should be discouraged by State Governments, or at any rate, not seem to receive their specific approval. The law of demand and supply and the price levels in the market will themselves be limiting factors on the dealers' attempts to overcharge. Issue of vouchers and cash memos, however, should be made compulsory for registered dealers, or at any rate, for such of them as have a turnover which exceeds a prescribed level. This would be specially appropriate for the single-point levy.

#### *Evasion and avoidance of tax*

20. Evasion and avoidance of tax are occasioned by various contexts and reasons (some of which have already been incidentally referred to) such as:

- (1) constitutional restrictions;
- (2) lack of definiteness and precision in specifying categories of either special goods or exemptions;
- (3) collusion between dealer and his customer; and
- (4) administrative complexities.

Earlier, we have discussed the scope for avoidance of tax which has arisen under the operation of Article 286 in its bearing on inter-State trade. We believe this will be substantially reduced if our main recommendations are adopted; as already explained, one of the objects of our proposals is to eliminate the incentive which now exists for consumers and unregistered dealers in

one State to buy from the dealers of another State when ordinarily they would have bought from registered dealers of their own State. In regard to the second category mentioned above, many of the State Acts and Regulations are themselves partly responsible for the evasion. Thus, as a rule, when exemptions (or higher rates) are related to prices below (or above) certain specified limits, instead of to the whole of a precisely definable class of goods, scope is afforded to the dealers to under-price the goods in their bills or books of accounts and in that manner evade the tax. It is therefore necessary to keep 'price' categories, as distinguished from 'class' categories, to the bare minimum, if indeed they cannot be eliminated altogether; further, in defining 'class' categories, it is necessary not only to be precise in the legal sense, but to take into account various considerations, including the simplicity and definiteness required, from the point of view of both trade and administration. We have already dealt with this in connection with exemptions. We have also referred to collusion between dealer and customer; so far as the former is concerned, it may be emphasised here that it is not just sales tax but also income-tax which the dealer is anxious to evade by not giving vouchers and not including certain transactions in the accounts he maintains. The complexities introduced from time to time into the different sales tax systems are responsible for an appreciable degree of evasion and avoidance. Several rules and regulations made for the purpose of reducing evasion, widening concessions, or increasing revenue involve the maintenance of complicated accounts and the submission of detailed returns by way of proof or evidence. Where these requirements are not fulfilled, the dealer runs the risk of paying the tax from his own profits. This is only one aspect of a context in which bribery and corruption have readily assumed serious proportions. There is great need - and considerable scope - for simplifying the administrative requirements, including accounts, forms of return, etc. Further, it is necessary to pay much more attention than at

present to supervision, including surprise checks, by the higher officers of the Department. Similarly, assessments made by the lower officers should be test-audited more frequently. Another direction in which the problem of evasion can be tackled is for the State Governments to make arrangements with the customs and railway authorities for exchange of information; there could also, in the same connection, much greater co-ordination between the Sales Tax departments of different States. Sometimes co-ordination is lacking even between different Sales Tax Offices within the same State. We shall later revert to the question of co-ordination. Meanwhile, among the methods of evasion practised, may be noticed the following two categories:-

- (1) Manipulation of accounts; omission of some of the taxable sales from books and records; suppression of other transactions (e.g., purchases) in the light of which the sales can be verified; under-estimation of production, imports and sales by manufacturers and importers; falsified entries in declaration forms and certificates; showing separately sales of bullion and sales of services even when ready-made gold and silver ornaments are sold; and
- (2) Carrying on business without registration; splitting up of business so that the turnover may be below the taxable limit; changing place of business, name of firm, etc., when assessment becomes due, or disappearing altogether from the jurisdiction of the particular State.

21. Various attempts are made by State Governments to prevent such evasion. Under the sales tax statutes, powers have been given to the sales tax officers to search the dealers' premises, to seize their books, etc. Heavy fines and cancellation of registration certificates are also prescribed as penalties for evasion of tax. Evasion continues in spite of these, and experience has

shown that the more complicated the tax system, the more the prevalence of evasion and the greater the scope for corruption.

#### *Sales Tax Advisory Committees*

22. For the maintenance of a proper liaison with the trade and industry, it is necessary that the Sales Tax Department should maintain some contact with the chambers and associations of different trades, industries and commerce and get their advice and help in administering the tax. It is obviously neither possible nor desirable that sales tax officers should directly deal with all such associations. A small Committee representing the important sections of trade, industry and the consumers would serve this purpose much better. Such Committees have been established in one or two States and are reported to have proved successful in meeting the grievances of traders and ensuring their co-operation in the administration of the tax. We recommend that in each State there should be a Sales Tax Advisory Committee consisting of the representatives of different trade interests. It is necessary to lay down that the sales tax matters discussed by these Committees should be those of general interest to the trade and not items of individual dispute or grievance relating to particular assessments or particular dealers.

#### *Sales Tax Tribunals*

23. It is necessary that there should be an independent authority in each State to decide the final appeals on sales tax disputes between the Department and the dealer. In most States, at present, the appeals lie to the higher executive authorities; but these do not create the same confidence in the minds of the dealers as an independent appellate authority would. Some States have already established such independent Sales Tax Tribunals in their States; and these are reported to be working satisfactorily. These

Tribunals consist of senior persons having judicial, accountancy and business experience. We recommend the establishment of such tribunals in all States.

*Co-ordination: Inter-State Taxation Council*

24. We have already dealt with the constitutional and legal aspects of co-ordination between the Union and the States in matters pertaining to the regulation and levy of the sales tax. In the administration of the tax, there is constant need for exchange of information between one State and another. Further, there are occasions when it is necessary to have consultations with the Sales Tax Departments of other States on specific matters of common interest and on general problems affecting more than one State. Moreover, any exchange of information regarding the methods of assessment, maintenance of accounts and other procedural matters is likely to be very useful in improving the efficiency of the Department as a whole, and making it a more useful instrument of tax collection. It is hence desirable that there should be meetings of the heads of Sales Tax Departments of all States at least once a year to have discussions on topics of mutual interest. We recommend annual conferences for this purpose under the auspices of the Inter-State Taxation Council the creation of which we propose elsewhere in this Report. The representatives of the Central Government would also, of course, have a definite part to play in such conferences.

*Uniformity in sales tax law and procedure*

25. Finally, we would make the concrete suggestion that the Inter-State Taxation Council

should undertake the task of introducing as much uniformity as possible, between different States, in the matter of sales tax law, regulation, procedure and forms in so far as these can be distinguished from, or are not concerned with, actual rates, turnover limits, exemptions, etc. At present, the definitions of terms like 'dealer', 'sale price', 'turnover', 'year', etc., differ widely from State to State. This leads to their interpretation and judicial construction being different in different States and creates unnecessary complications and hardships to the trade and industry, particularly in regard to inter-State transactions and for dealers who have branches in more than one State. The procedure for filing returns and payment of tax, for assessment, for appeals and revision, etc., and the regulations regarding maintenance and inspection of accounts also vary considerably between the different States. The same lack of uniformity is to be found even in the forms of returns, forms for refunds and adjustments, the type of evidence to be produced for sales outside the State, etc. Without conferring any advantage whatsoever on individual States, this diversity in regulation and procedure creates many avoidable difficulties for trade, commerce and industry. In forms and procedure, in particular, and even in regard to the structure of different Sales Tax Acts and the definitions adopted in them - though not, as we have stated, in rates, exemptions, registration limits, etc., - it is not only possible but extremely desirable that as large a measure of uniformity as feasible should be aimed at and achieved. We consider that the Inter-State Taxation Council, as soon as it is established, should take this up as one of its very first tasks in the context of the sales tax.

# REVIEW ARTICLE\*

## HEGEMONY IN INDIA: A HISTORICAL PERSPECTIVE

Suneeti Rao

### INTRODUCTION

Power is 'the central fact of the history of human experience ...power constitutes the dominant moment of all relations in society and culture' (emphasis original) (Vol. III, p. 11). Power is defined by Max Weber as the possibility of imposing one's will upon the behaviour of other persons. Such imposition is always met with resistance. Yet, '(t)here is plurality of resistances' (Vol. III, p. 80). For, power may be exercised in various ways. Three reasonably obvious facets of such exercise of power are: through coercion, with others unwillingly submitting to it out of fear (condign power); through bargain where submission is won through rewards (compensatory power); or through astute strategy when submission is a willing choice out of conviction that it is the proper course (conditioned power) [Galbraith, 1984]. Here the authors expound the concept of hegemonic power, which is similar, though not identical to Galbraith's conditioned power.

Power embodies the interaction between *domination* and its logical implication- *subordination*. Each of them, in its turn, comprise two elements: (i) coercion and persuasion, and (ii) collaboration and resistance, respectively. Thus, in the ultimate analysis power is determined by these two pairs of interacting elements. When persuasion outweighs coercion in establishing and maintaining *domination*, it is an instance of hegemonic power. Obviously, such hegemonic power is sustained better when *subordination* is of such a complexion as resistance is neutralized by collaboration. 'Force, military or economic, can be imposed on human objects but for power to be established, that is, for *force* to be translated into *power*, human subjects must acknowledge and recognise it- happily or otherwise' (Vol. III, p. 80); happily acknowledged out of 'the Humean idiom of Obedience ... (and) the Indian tradition

of *Bhakti*. Alternatively, as Dumont puts it, acceptance of power is through legitimisation, tinging it with principle, value or ideology such as 'legalism and constitutionalism and the many shades of compromise between collaboration and dissent' [Guha, 1989]. Culturally conditioned, an Indian wife submits to her husband's domination. Ideologically inspired by the cause, the LTTE terrorists are commanded by their leader, to the extent that as human bombs they willingly lay their life. Thus, 'all power is cultural-ideological power.... Power, (nevertheless), is not an attribute that some possess more than others, but a network of relations' between the dominating and the dominated, i.e., even the dominated have some hold on the dominating (Vol. III, Pp. 80-81). Because of the complicity of the dominated, their resistance is disguised, embedded in accommodation, adaptation and adjustment with power. Thus, hegemonic power adapts itself to subsume resistance. 'By defining the borders of what is possible to accommodate, the adaptors resist encroachment beyond a certain frontier.... (H)egemony is both domination/resistance plus accommodation/ absorption' (Vol. III, p. 75).

Gramsci was the first Marxist to provide insights into such complex faces of power, specifically, of the two kinds of state power: the autocratic absolutism and the democratic capitalism. He perceived 'the fundamental distinction between the Tsarist state and the European states and the need for a different strategy to carry on a revolutionary transformation' (Vol. II, p. 13). Hence, analysing hegemony without referring to Antonio Gramsci's *Prison Notebooks* is inconceivable. In the three volumes under review, the authors 'seek to examine our historical evidence in the light of Gramsci's statement that a social group can, and indeed must, already exercise leadership (be hegemonic) before winning governmental power; this indeed is one of

\*Joshi, Shashi and Bhagwan Joshi, 1992-94; *Struggle for Hegemony in India: 1920-47*, Vol. I: 1920-34 *The Colonial State, the Left and the National Movement*; Vol. II: 1934-41 *The Colonial State, the Left and the National Movement*; and Vol. III: 1941-47 *Culture, Community and Power*, Sage Publications, New Delhi.

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the principal conditions for the winning of such power' (Vol. I, p. 27). They apply the Gramscian concept of hegemony 'to analyse concretely the processes of evolution, crisis and dismantling/transformation of a historically constituted form of (colonial) state' (Vol. II, p. 13). They do not desire to undertake here any rewriting of Indian history, and rightly so. Their representation consists of juxtaposing Indian conditions and Gramsci's concept of hegemony. This concept is presented here as comprehended by them so that it is relevant to Indian conditions. Another reason for interpreting Gramsci afresh is that the authors like the postmodernists believe: 'Texts have a remarkable way of saying different things to different minds' (Vol. I, p. 27). Josh is of the opinion that Gramsci himself uses the term 'hegemony' in a multitude of different contexts. His theory of hegemony is, therefore, likely to suffer from ambiguities, incoherence and discrepancies. It is necessary to avoid such equivocality. But before discussing their interpretation, it would be worthwhile to recapitulate Gramsci's views on hegemony, both the concept of hegemony, as well as its praxis, the willed action by which the concept becomes social actuality in the highly developed societies of the West. Conceptually, hegemony 'aspires to establish not coercive but legitimate, enduring power relations. ...For Gramsci, a crucial conceptual distinction exists between power based on *domination* and the exercise of *direction* or *hegemony*' (Vol. I, p. 26; Vol. III, p. 11). It is realised not *externally* by rewards or punishments, but *internally* by *consent*, by steering personal behaviour, choice and convictions into a set pattern of accepted norms. Hegemony is a kind of supremacy of one social group or class over other classes, a normal form of social control. It is reflected in the intellectual and moral leadership. In praxis, hegemony, is the most important face of power in any post-feudal society and the strength of the advanced capitalist society. It can emanate well only in a civil society. Educational, religious and associational institutions as well as technical instruments, like the media, can flourish only in a civil society. They

lay out the cognitive and subconscious ideological structure in the light of which people perceive and evaluate social and political reality. State in the integral sense equals to political society plus civil society. In other words, the state is 'the entire complex of political and theoretical activity by which the ruling classes not only justify and maintain their domination but also succeed in obtaining the active consent of the governed' [Femia, 1981, p. 28].

The authors redefine Gramsci's concept of hegemony thus: 'In our understanding, when the term 'hegemonic' is used "as an opposite of economic corporate to designate a historical phase in which a given group moves beyond a position of corporate existence and defence of its economic position and aspires to a position of leadership in the political and social arena", then this usage is precisely the kind we are trying to insert into our historical material' (Vol. I, p. 26). 'By discussing Gramsci's theories in the context of mass movements, political representation, group alliances, ideological struggles, domination- subordination, conflict of interests between social groups and his insights into the specificity of the state structure and strategies we evolve a new framework for the study of this theme' - the historic milestone of transfer of power in India on August 15, 1947, and its preceding events until 1920 (Vol. I, p. 7, Preface). However, while thus recasting history in the theoretical mould of Gramscian hegemony and aspiring to explode the myths woven around India's winning freedom and thus bring about a paradigm shift in Indian history, the authors seem to overlook that Gramsci himself does not conceive history as 'a rational process whose dynamic structure was penetrable by the theorist' [Femia, 1981, Pp. 126-127]. As a result, the authors fail to provide a 'new-level analysis' either of Indian history or of Gramscian hegemony; they do not 'reach another level of concepts, concepts that are more basic, more fundamental, than the ones under analysis, ....' particularly in the third volume [Avramides, 1989, p. 20]. Still, the analysis does help to clarify the concepts involved and also their interdependence.



The so-called 'new paradigm' constructed by the authors reveals 'the specific form and uniqueness of British rule in India' and 'the rise of a mass movement, i.e., a protracted struggle to build national hegemony/ state within state'. In the process, 'the logic of transfer of power rather than a violent seizure of state power' is evinced (Vol. III, p. 7). It is well-known who won access to power, both hegemonic and repressive, and who lost and surrendered the reins of power. But little is written, the authors contend, about this 'national experience' as a totality. To be truly christened as 'national', it is necessary to include reflections on those who also ran but lost the race to the corridors of power- the Leftist parties. 'By conceptualising the period not in terms of a 'dual contest'- Congress and the *Raj*- but in terms of a 'triangular contest' we introduce a very fundamental change in the reconstruction of the 'national experience'. If one essential part of the picture is changed, then the other parts of the picture also change. It becomes a different picture, a very, very different history' (Vol. III, p. 8). The authors thus undertake here, in Edward de Bono's idiom, an exercise in *lateral thinking* on the desk history of our struggle for Independence. The protagonists are the Leftists, specifically the Communists, and not the subaltern combatants belonging to tribals, the so-called low castes, landless agricultural labour, plantation labour, peasants, mine workers, urban casual labour, and other non-elite classes who took spontaneous initiative to lead masses to upsurge, for example Jitu Santal, who led the movement in Malda in Bengal in 1924-32 [Sarkar, 1985]; or, Baba Ramachandra, a Maharashtrian of uncertain antecedents, who in 1920-21 led the movement of Pratapgarh Kisan Sabha in Awadh (which caused Jawaharlal Nehru to 'discover' peasantry in India) [Pandey, 1982]. For, in the authors' opinion, these subaltern 'heroes, despite appearing in brilliant but brief flashes on the political scene, do not constitute the 'national experience' (Vol. III, p. 8). Yet, the authors' intention of making the Communists the protagonists is realised in the trilogy more as an exception than

as a rule. Most of the hegemonic contests delineated in the trilogy are between the colonial state and the Indian National Congress (INC). Perhaps, it happened because 'the paradigm of hegemony and the paradigm of insurrection (Communism) were mutually exclusive', inherently incompatible (Vol. I, p. 355). Why do the authors then knowingly opt for such contradiction? At any rate, their methodology brings to light some novel facets of the nation-building processes in the pre-Independence India.

Finally, the triangular contest for hegemony- for influencing, leading and, eventually, representing the Indian people- 'involves gain or loss of prestige, respect, honour, influence, and above all, authority over the various sections of the population. It is in this sense that we shall be employing the concept while referring to the struggle/ moves/ compromises/ negotiations (a) between the colonial state and the national movement as a whole, and (b) between various ideological currents, especially the Congress right-wing and left-wing, the two contending hegemonies within the national movement' (Vol. II, Pp. 13-14). The contest between the nationalists and the colonial state was a war of strategies, while the Communists struggled to carve out the militants from the nationalists and tried to win them to the Communist ideology, each moving in to occupy ideological space left vacant by the other. These intrigues, also the factors responsible for the ultimate success of the nationalists are assessed in the first two volumes which reconstruct this political project of establishing hegemony. The first volume (1920-34) is authored exclusively by Shashi Joshi and the second (1934-41), likewise, solely by Bhagwan Joshi; while the social-cultural project of integrating hegemony is focussed in the third volume (1941-47), penned by both of them together. With the fall of Communism in Russia and other East European countries, and the democratization of the Communists in India, the political history in the first two volumes is more of abstract and historical interest, but the last one, exploring communalism and characterising religion based conflicts as cultural contestations, is of direct

relevance today. In this volume, the three contestants for cultural hegemony are initially the ideologues of the two communities, the Hindus and the Muslims, with the medieval and colonial state as referee. Later on, the contest is among the Muslim nationalism, Hindu nationalism and 'the supposedly culture neutral, liberal nationalism'. The Leftists, 'upholding secular theories/politics of *nation* and *class*' and 'delivering pious sermons' were either marginalised, or they consciously or unconsciously slipped into one of the contesting internalities (Vol. III, Pp. 346-50). The significance of the third volume is further underscored because this trilogy delineates on hegemony, defined as 'culturally mediated power' (Vol. III, p. 84). 'The struggle for cultural hegemony is a struggle not just for power but for 'power above power', that is, it is not merely a struggle to control the state but for the right to specify the terms under which direction of the state is granted', i.e., the right not merely to govern but also to represent the country, to define the 'we' in it, the 'we' who 'cannot escape our cultural selves' (Vol. III, Pp. 354-355). 'The struggle for power is about social conditions and cultural forms as sites of political tension' (Vol. III, p. 11).

#### TRIANGULAR CONTEST FOR POLITICAL HEGEMONY

Josh accepts Gramsci's formulation of India's political struggle against the colonial state as three forms of war: war of position, war of movement, and underground warfare. He interprets Gramsci thus: Gandhi followed a strategy of 'war of position' epitomised by boycotts, passive resistance, hunger strikes, mass rallies, etc. The Communists followed a strategy of 'war of movement', strikes being its most obvious form, while revolutionary insurrectionists used methods of 'underground warfare', with the secret preparation of weapons and combat troops. It was obvious that political power could be captured from the British *not* at one blow through a frontal attack but gradually, blow by blow, 'recovering ground from the enemy inch by inch by adopting a strategy of 'war of position' (Vol. II, p. 74). For, the colonial state was well aware of the

'immutable maxim that government of the people is possible only so long as they consent either consciously or unconsciously to be governed' (Vol. I, p. 31). Also, it knew that 'the only way power represents itself in society' is 'in terms of a solution to longstanding human problems' (Vol. III, p. 311). Hence, it identified the people-nation with itself, as the state representing the nation, that is, the people. It presented its authority as legitimate through reforms. Constitutionalism was introduced within the colonial framework' through legislation, like the Government of India Acts of 1858, 1909, 1919 and 1935. 'The successive reforms by the British Parliament were designed to serve a three-fold aim: (a) to prove the legitimacy of liberal credentials, (b) to accommodate and absorb the nationalist opposition, and (c) to diffuse and split the gathering forces of Indian Nationalism' (Vol. II, p. 50). The colonial state assumed a sort of hegemonic character which was manifest through '(t)he ideological infrastructure of 'legality' and 'legitimacy' on the basis of which the government claimed to rule' (Vol. I, p. 20). It justified its laws, even restrictive laws, by managing to pass them through legislative councils. This conception of justification forced it, to a certain extent, to be sensitive to public opinion. Further, it projected itself as the arbiter of diverse Indian economic and social interests, also as the source of concessions, patronage and gradual reforms, in addition to rewards and punishments. It took pains not to appear arbitrary, to retain civil authority and avoid drastic, military intervention. As the Home Secretary, Emerson, puts it 'Generally speaking, it is undoubtedly desirable to retain the authority of the civil authorities so long as possible; and if the needs of the situation can be met by the grant to them, instead of military, of drastic powers, so much the better' (Vol. I, Pp. 14-15). In reality, the colonial state pursued what came to be known as the 'divide and rule policy', by wooing and protecting only certain sections of society, also by encouraging the myriad casteist, communal, provincial and parochial segments existing in the Indian society to become

articulate and then to utilise the divisive tendencies to justify its role as the arbiter- the dispenser of justice. 'The more it is made obvious,' writes Lord Birkenhead to Lord Reading, 'that these antagonisms are profound and affect immense and irreconcilable sections of the population, the more conspicuously is the fact illustrated that we and we alone can play the part of composer' (Vol. I, p. 20).

How does one explain such contradictions? The authors' conception of hegemony comprise 'a relation of domination by means *not* of force, but of consent, by means of political and ideological leadership' (emphasis added) (Vol. II, p. 13). *Consent* to Gramsci is a frame of mind, where people conform because they believe that demand for conformity is legitimate, justified and moral. However, the 'consent' of the colonial people was obtained by playing *politics*, i.e., through manipulation, through creating and maintaining alliances which involved compromises, accommodation and concessions of an economic-corporate nature; 'when opposing interests and world-views compel each other to temporarily accommodate and adjust with the long-term goal of replacing the other', such consent is gained (Vol. I, p. 15). On the contrary, real, genuine consent is rooted in the representative system. The colonial state, in spite of its many characteristics of the modern Western European states, opposed vehemently any kind of representative system as unsuitable for India. Its hegemonic moves were to convert its opponents, i.e., the nationalists into collaborators. Their 'collaboration' with the colonial regime would have meant that their perceived interests and goals were common. But it was not the case. As far as the nationalists were concerned, they collaborated as a stopgap arrangement, generally to gain some breathing time in their struggle so that they could have organised themselves more effectively for the next move, whereas in the case of the colonial state, 'the imperialist content of its policies and the hard core of its exploitative functions' did not alter (Vol. I, Pp. 14-15). The authors, therefore, designate the colonial state as semi-hegemonic in

character. A better epithet would be pseudo-hegemonic, for 'semi' indicates intermediate, halfway and has a positive ambience, which was absent in the colonial rule, while pseudo signifies sham and hypocrisy.

The colonial state's claim for hegemony can be further questioned with the help of Gramscian theory of hegemony. Gramsci speaks of two variants of hegemony which the authors do not refer to. 'Concerning the methods by which a class can become hegemonic, Gramsci distinguishes two principal routes: the first is that of transformism and the second is that of expansive hegemony. Let us first take *transformism*. ... This naturally (is) a bastard form hegemony ... since the masses (are) integrated through a system of absorption and neutralisation of their interests in such a way as to prevent them from opposing those of the hegemonic class. Gramsci contrasted this type of hegemony through absorption by what he called successful hegemony, that is to say, *expansive hegemony*.... resulting from the genuine adoption of the interests of the popular classes by the hegemonic class, ...' [Mouffe, 1979, p. 182]. The colonial state unquestionably followed the former route, while the nationalists the latter. In other words, 'if hegemony is defined as the ability of one class to articulate the interest of other social groups to its own, it is now possible to see that this can be done in two different ways: the interests of these groups can either be articulated so as to neutralise them and hence to prevent the development of their own specific demands (that is what the colonial state did), or else they can be articulated in such a way as to promote their full development leading to the final resolution of the contradictions which they express' (this is what the nationalists aspired to do) [Mouffe, 1979, p. 183].

Moreover, the Universalist urge of capitalist economy to expand brought the British to India in search of pastures new for their trade. The genesis of the colonial state, thus, lay in mercantile, military and political domination, outside the indigenous social formation. It propelled the Indian state along the path of western developments- such as the primacy of rationalist

thought, the empirical method, modern science and technology, capitalist economy and welfare state. It almost succeeded in convincing people of India that such a changeover is the only desirable universally valid emancipation. In conformity with this world-view, it emerged as the principal planner, the legitimate mobiliser for progress and welfare of people. However, it never allowed the people who were apparently to be benefited through such endeavour to participate. Naturally, it ended as the agent for the dislocation and retardation of India's internal economy simultaneous with her integration with world capitalist economy [Wilson, 1994, Pp. 246-273]. Yet, until the nationalist movement commenced, it positively propagated the delusion that it was on a mission of civilising and emancipating Indian natives. How? *Authority* over people can be exercised in two ways: *having authority* and *being authority*. In his conception of hegemonic authority, Gramsci accentuates *being authority*, which is grounded not only in the competence of that authority to fulfil certain social functions, but equally in the very essence of its character which radiates authority without resorting to orders, threats or bribe. Compliance to the authority involves both external behaviour and internal attitude of mind, a feeling of being bound to conform. With the loss of competence-forming qualities for whatever reasons, the process of alienation of authority occurs. The external signs of competence, which the authority wears through symbols of authority, such as form or title, replace the real competence and its qualities. People accept these symbolic heralds, not because of coercion, but because their realistic, critical thinking and judgment are dulled, they are made to believe the fiction, and their mind is lulled into submission by myths, clichés, blinded to reality through the internalisation of the pre-eminent ideology. It is an instance of merely *having authority* not *being authority*. As long as people comply, even *having authority* with the crutches of paraphernalia helps. Rulers thus retain authority, while their contenders strive to gain it by disrobing the rulers of such trappings. By and large, the colonial state exercised such pseudo

authority. Through indoctrination and ideology, it practised the art of 'how to break a person's will without his being aware of it, ... unaware that the will itself was conditioned, manipulated' [Fromme, 1976]. The colonial state was thus an instance of *having authority* over people through machinations, fetish and illusion. As a result, the nationalists had to fight the war of position on two terrains simultaneously to win both, (i) the power from the colonial state, and (ii) the hearts of the Indian people. The Congress 'had fairly early recognised- indeed so early as in 1920-21- that in fighting the British power, the Congress had also to take on hand a constructive programme in order to *reconquer India* from the British who had, through a century's conscious and deliberate striving, effected a moral and spiritual, economic and social conquest as well, not merely a political and territorial conquest' (Vol. II, p. 50).

#### *War of Position*

(i) *Conquering Power from the Colonial State:* The authors explain in great detail, although not so cohesively, the positions, i.e., the strategies adopted by the two adversaries in this war for political power in India. Formidable, modern, ever-vigilant, armed to the teeth and capable of substantial destruction, the colonial state perpetuated itself on the in-built two-pronged strategy: manipulate and convert as many forms of opposition as possible into constitutional opposition and neutralise it by absorption within its framework; or drive underground all frontally attacking and insurrectionary forces and then destroy and disorganise them systematically. That is what it did in the case of most of the Leftists, whereas the moderates from the nationalists were neutralised. Its strategy to deal with the Congress-led national movement was 'manifest in the twin policy of offering negotiations while executing military operations and assuming emergency powers. The movement was constantly presented with a polarised choice: either to move towards constitutionalism or face repression on a scale that could be fatal' (Vol. I, p. 16). Still, the channels of communication were

always left open, or devised accordingly. Instead of conceding the entire demand of the opposition, the colonial state was willing to accommodate a part of it, ready to lose a 'bit' of the ground under its own feet, e.g., instituting provincial autonomy in 1937. It hoped to take the wind out of the sails of the nationalist movement not only by neutralising a section of the opposition but also by creating divisions and dissents in the rest. Thus, the colonial state consistently strove to confine opposition to legislatures and assemblies and to offer concession with coercion, for instance, the Rowlatt legislation and Montagu's Reform Bill. What it, however, did not anticipate but transpired was that the nationalists formulated counter-strategy, both political and ideological, of turning every act of so-called collaboration 'in working the system into its opposite', into 'a demand for continuously increasing political space for the Indian people, rousing and mobilising ever larger sections of people' (Vol. I, p. 15). On the political level, the policy of the INC was to accept what was given, and keep up an agitation for getting more. 'The brilliance of the counter-strategy adopted by the Gandhi-led Congress lay in converting negotiations and compromises into channels of further erosion of state authority rather than allowing them to become vehicles of constitutionalism as desired by the state' (Vol. I, p. 16). This strategy was basically characterised by periods of mass movement with intervals of truce. The latter were utilised to forge close ties with the people, to consolidate people's power through constructive programmes for uplifting of villages, Harijans and women. Knowing the significance of these programmes, the colonial state felt extremely threatened by them. Thus, the INC followed a strategy of 'war of manoeuvre', 'to create a powerful impression on the policy-makers while ... always be willing to negotiate and bargain to recover maximum ground and space for manoeuvrability' (Vol. II, p. 74).

On the ideological plain too, the INC adopted a superior strategy. It perceived that disguised muscle power was writ large at every level of the colonial rule, even within the apparatuses generally regarded as 'ideological' rather than

'repressive', for instance, a constitutional and legal framework for trade unionism was evolved to foster labour organisations, but they were required to be totally apolitical and political organisation of labour was made very difficult (Vol. I, p. 355). Also, whenever expedient, the colonial state resorted to 'hegemony armoured by coercion'; 'the iron heel had cowed down the people' quite often and made them suffer 'the prolonged torture of Ordinance Rule' (Vol. II, p. 70). Nevertheless, 'as the colonial state was not absolute in character, it consciously chose to promote what is considered *legal* forms of political representation. The nationalist strategy of questioning the very concept of what was *legal* from the point of view of civil liberties and citizens' rights transformed the very notion of *legality* (Vol. I, p. 63). Edmund Burke and M. Poincare were quoted by the nationalists to assert that the declaration of the fundamental rights of humanity was the 'Law of all Laws'. Legality comprises both: (i) the various, discrete, individual rules of law enumerating rights and duties (positive law); and (ii) the basic, natural principles evolved from public opinion, morality and ethics (natural law). The latter are of a higher order, uphold higher standards and provide the rationale for the former. From the days of the ancient Greeks, various positive laws enacted by the sovereign law-making authority, whether a duly elected parliament or a dictator, are challenged and an appeal is made to the natural law if they are not consistent with it, for instance, Antigone's protest against the tyrant's decree. The INC did the same, e.g., Bal Gangadher Tilak's appeal to the principle that liberty is everybody's birth-right, or Mahatma Gandhi's call to disobey the colonial laws on the basis of *lex injustia non est lex* (unjust laws are not laws), which is the basic tenet of the natural law. It was pointed out that 'if a statute or judicial decision passes the line of those duties which good and intelligent men as body accept and impose upon themselves, it is at once nullified. The process of nullifying law has sometimes been called passive resistance'

[Nehru, 1979, Vol. 7, p. 486]. (Neither Gramsci nor the authors have this formulation of 'passive revolution'; their conception is discussed in the next section). Civil Disobedience was thus held as the unquestionable right of all people suffering from grave wrongs, if they had failed to obtain redress by other constitutional methods. Further, boycott of schools, colleges and law courts, championed by Gandhi, was instrumental in destroying its moral prestige created by it through such educational and legal institutions. Awe, authority and moral prestige are a *sine qua non* of hegemonic control as opposed to brute force of a purely repressive state. The essence of the Gandhian strategy was to destroy them and deprive the colonial state of its ideological hegemony. The bureaucracy could be paralysed through peaceful civil resistance and non-violent non-cooperation. The colonial state with all its repressive machinery 'could never defeat resistance of this character. It may kill, but the very dead will work for its overthrow' (Vol. I, p. 71).

Such a politico-ideological solution was adapted to the existent Indian circumstances and steered clear of armed misadventure and constitutional conformism. 'The political process ... moved through a dynamic of shifting power relations. Each time the mass movement disturbed the earlier equilibrium to establish a new one it sapped the strength of the state to some extent, while the Congress organisation and the mass movement correspondingly gained a sense of strength and power' (Vol. II, Pp. 74-75).

(ii) *Reconquering the Hearts of the Indian People*: The INC strategy proved more effective on the ideological plain for one more reason—reconquering the people's hearts. The colonial state 'allowed some scope for the expression of popular feeling'. Its policies and actions were usually calculated on the basis of public opinion in general, and after giving due consideration and weightage to the attitudes of the concerned social groups to the action contemplated, in particular. Consequently, its ideological onslaught combined with its physical force created in

Indians a 'defeatist, slave mentality, ... a state of spiritual paralysis, of mental torpor, inertia and despair. There are fetters, ... economic, social and political which have created and imprisoned life. At the bottom they are psychological and ethical complexes. The fetters can be removed only by an effort that produces a psychological and ethical awakening and expansion. And this can be effected only through a course of voluntary suffering and selfless sacrifice' (Vol. II, Pp. 17-18). Gandhi embarked on such a course through the constructive programmes. The colonial state was represented at its real level through the district administration which was based not on a display of power, but on the consent of respect. And the administration would not function, if that respect was eroded. Hence, to meet the Gandhian challenge, it introduced certain schemes such as allocation of separate funds for rural development, and asking every district officer: 'Know your villages', so that he could regain his lost position as 'the recognised leader of the rural population in all schemes of improvement and development' (Vol. II, Pp. 18-19). But, with the successive instalments of constitutional reforms, the administration was no longer in a position to influence appointments to local self-governing bodies. 'This loss of patronage ... had been a great blow to their prestige. This process of erosion of British influence and authority ... was going on in almost all the districts' (Vol. II, p. 19). The colonial state's willingness to negotiate with Gandhi was interpreted as its weakness, as it being 'on the run'. The Gandhi-Irwin Pact 'raised Gandhi to the level of a plenipotentiary on equal terms with the Viceroy', 'practically the head of a parallel Government' and confirmed the impression that the final victory of the INC 'was only a matter of time'. Later on, 'colonial authorities judged any proposed course of action not so much by its possible effects on the Congress, but by its probable effects on their supporters, officers and men' (Vol. II, p. 70).

Further, the Gandhian strategy of launching constructive programmes mentioned earlier not only effectively confronted the colonial district administration but also integrated the disparate interests of the propertied and the labouring classes, so that all the conflicting interests could rally round the INC. 'Gandhi ... made the peasantry willing participants in a struggle wholly conceived and directed by others, namely the bourgeoisie' [Pantham, 1995, p. 31]. He believed in the ideological unity of the nationalist thought which should disregard all contradictions, divergences and differences. In his opinion, unless political freedom from the British was singled out as the immediate objective, neither socialism nor freedom was feasible. Socialism would have diluted the participation of the propertied classes, which was at that time indispensable. Unlike an ordinary bourgeois party like the present day Congress, the INC in those days consisted of the mainstream of nationalists and was in the true sense a people's party which 'allows any national programme to be preached within its ranks which might be more radical than the consensus programme. And not only that, it also keeps open the possibility of such a platform acquiring a majority and becoming dominant within the organisation. ... The willingness to have mutual adjustment and compromise between the structurally antagonistic classes ... form(s) an organic whole of the growing (national) consciousness. ... (It arose from) the recognition of the historical necessity of uniting all the forces involved in the process of nation-in-the-making against imperialism' (Vol. II, p. 65). Among the 'whole spectrum of ideologies from liberal constitutionalism to socialism' in the INC, struggling for hegemonic influence over the Indian society to represent it in the movement for liberation, the two main currents were: (i) constitutional- moderates and rightists, and (ii) non-constitutional- *satyagrahis*, leftists, radicals and militants. Gandhi was 'the unifier of the generalised impulse of anti-imperialism in Indian society' transcending the polarities of political action (Vol. I, p. 32). For, 'Gandhi himself led and guided the non-constitutional

current throughout his political career and in times of constitutional experiments, chose to withdraw into mass work which can be interpreted as preparatory work for launching mass movements' (Vol. I, p. 18). Gramsci states, 'if the union of two forces is necessary to defeat a third, ... the only concrete possibility is compromise' (Vol. I, p. 37). In order to successfully form a new, homogeneous politico-economic historical bloc, without internal contradictions, the political direction of certain groups had to be changed on the road to building the anti-imperialist hegemony of the INC. Nehru 'was the only nationalist leader to initiate the process of transformation in the national movement towards the left ... (and) also envisaged an effective hegemony for the left at the end of such a process of transformation' (Vol. I, Pp. 32-33). Despite accepting Gandhi as the universally acclaimed leader of the INC-led movement, an open-ended and multi-class movement of all, Nehru differentiated himself ideologically from many Gandhian views, like trusteeship and *Rama Rajya*. He, therefore, infused a new spirit into the Gandhian idiom. 'For example, (he advocated) the conception of *Dharma* changes from age to age ... greater than any man is the idea ... the *avatars* of today are great ideals ... and the ideal of the day is social equality' (Vol. I, p. 175). Also, the activities of the youth and students, their mobilisation in the national movement as a group, not as individuals as in the non-cooperation days, provided the soil for the emerging left bloc. Gradually, the spirit of radicalisation permeated the INC rank and file. These changes may be termed as 'passive revolution', an expression borrowed from Cuoco. Gramsci observes: 'One may apply to the concept of passive revolution the interpretative criterion of molecular changes which in fact progressively modify the pre-existing composition of forces, and hence become the matrix of new changes' (Vol. I, p. 28). As the INC had been already gradually modified under Gandhi's initiatives, it provided the mould for further molecular transformations to be brought about under Nehru's leadership. It increasingly stood for *divesting of vested interests*, adopted agrarian programmes

and 'the *Swaraj* of the non-cooperation days was replaced by a *purna Swaraj* which ... talked of the fundamental rights of the masses' (Vol. II, p. 20). Thus 'Nehru was the first person, and this was his important contribution, to establish a new Marxist principle- the principle of organic relationship between nationalism and socialism' (Vol. II, p. 277). Accordingly, the nationalist ideology which initially asserted only the concept of racial equality soon absorbed within itself economic equality. Nehru asserts: 'Scientific socialism itself teaches us not to follow slavishly any dogma or any other country's example, which may have resulted from entirely different circumstances. Armed with a philosophy which reveals the inner workings of history and human relations, and with the scientific outlook to guide him, the socialist tries to solve the problems of each country in relation to its varied background and stage of economic development, and also in relation to the world' (Vol. II, p. 142).

#### *War of Movement: The Communist Ideologues*

In order to conquer political power from the colonial state in the true Bolshevik tradition, the Communists in India struggled 'to build an alternative anti-imperialist movement led by an illegal Communist Party committed to the overthrow' of both imperialism as well as capitalism (Vol. II, p. 11). Obviously, they failed on both the counts. Instead of a 'war of movement' through organising labour, in fact, they led a 'war for movement' which they could never really build on such a scale as could be effective. The authors discuss in depth the reasons for their failure- primarily their theoretical constraints. The Communists regarded Lenin's colonial theses of 1920 as something like a holy cow, a sacred scripture which 'already contained the essential guidelines for developing a harmoniously integrated theory, strategy and tactics of national democratic revolution in colonies' (Vol. I, p. 42). Originality of thought was surrendered to the infallibility of Marxism-Leninism, which was

supposed to be enshrined in the Comintern, the repository of the one and indivisible 'genuine' Marxism.

In the Marxist thought, nation and class are posited as two entirely different kinds of ideological movements. This was the first theoretical constraint which 'forced (the Indian Communists) into a framework based on the premise that ultimately each individual must represent this or that class interest. (Also, they) never distinguished between class and the party' (Vol. II, Pp. 66-67). They believed that nationalism was a bourgeois ideology, and viewed the struggle for national liberation merely as a part of the struggle of the working class in capitalist countries. It was a necessary first stage- a bourgeois-democratic stage under the leadership of the working class- in the strategy of the world Bolshevik revolution. Lenin was absolutely sure that such a revolution was imminent. The inevitability of the 'objective laws of historical development' and of 'favourable conditions' for revolution emerge from economic phenomena, that is, the increasing pauperisation of working masses. However, mere economic conditions, i.e., poverty, cannot be the cause of political revolution. The intervention of people's will 'operates within the dialectic of destruction/reconstruction. ... the automatic thrust (towards revolution) due to the economic factor is slowed down, obstructed or even momentarily broken by traditional ideological elements' (Vol. I, p. 36). Various illustrations of suppression of economic interests in favour of some ideological ones may be cited, such as wars have always proved economically disastrous both for the victor as well as the vanquished, yet nations do go to war for defending their national ideology or honour. Similarly, in our country funds are readily contributed to religious causes, but not to that extent to civic purposes, like construction of public toilets, roads, etc, which would improve the material well being of the people.



The Communists in India, always under the ideological pull of Marx, Lenin and the Comintern, lacked this understanding of history and its implications: 'the colonial economic exploitation and enslavement of the Indian people did not automatically generate anti-imperialist consciousness, ... (nor dislodged) the traditional view of the *Sarkar* (government) as the trustee of their well-being ... and of its being omnipotent and hence impossible or futile to oppose' (Vol. I, Pp. 36-37). It was necessary to educate the people, to inculcate disaffection towards the semi-hegemonic state and also to tear apart their 'fear of the government's repression and coercive machine, the colonial police and army' (Vol. I, p. 37). And that is what Gandhi did. He brought about the desired 'transformation of the Indian people from a people demoralised, timid and incapable of resistance, into a people with self-respect and self-reliance, resisting tyranny, and capable of united action and sacrifice for a large cause' under the leadership of the INC (Vol. II, Pp. 143-144). On the other hand, the Communists disregarded the psyche of the people and claimed that the relations of production were indispensable and independent of men's will and corresponded to a definite mode of production in material life. That 'conditions the general character of the social, political and spiritual process of life. It is not the consciousness of the men that determines their being, but on the contrary, their social being determines their consciousness' [Marx, 1859, *Preface*]. Further, M.N. Roy held that nationalism did not correspond to the 'economic interests of the rural and urban poor and consequently obstructed the development of class-consciousness; the anti-imperialist revolt of the masses was, primarily, due to economic causes and against the propertied classes whether British or Indian ... against the capitalist system' (Vol. I, Pp. 351-352).

The Indian Communists could never comprehend the Gandhian strategy of strengthening the Congress as a whole and desiring to remain united while creating spaces for any pro-poor, socially progressive ideology, and relating creatively to it. 'So long as the left was willing to mobilise the

workers and peasants within the ameliorative agrarian programmes of class adjustment and strategy of the Congress (leading along right channels, doing nothing but authorised Congress work) their activities to capture the Congress were perfectly legitimate' (Vol. II, p. 267). But due to 'the political logic of the left-wing groups' as well as of the radicals, the Communists interpreted the Congress strategy thus: 'The fundamental weakness of the Congress policy was that it was based not on radicalism but on adjustments-adjustments between the landlord and the tenant, between the capitalist and the wage earner, between the so-called upper classes and the so-called depressed classes, between men and women. I (i.e., Netaji Subhash Chandra Bose) do not believe that the Congress programme can win freedom for India' (Vol. II, Pp. 268-269).

Naturally, the Indian Communists struggled to form a separate party, overlooking the fact that the existing political and social conditions would shape the formation of the party, independent of their subjective desires. '(T)he Indian context required that no Communist Party be formed at all if the left-bloc was to remain together. In fact the continuous attempts to form a Communist party became the major obstacle in the path of left hegemony in India' (Vol. I, p. 34). 'The fact of hegemony, wrote Gramsci, presupposes that account is taken of the interests and tendencies of the groups ..., and that a certain balance of compromise should be formed' (Vol. II, p. 13). But the Communists have, on principle, aversion to adjustments and compromises which 'are considered unnecessary or even harmful' (Vol. I, p. 36). This aversion is closely linked to economism and stems from such compulsions like, a communist party must maintain a strict distance from an all class nationalist movement and an absolutely independent existence. 'A true Marxian ... will admit of no change in the body of the theories of his faith. Bolshevism has come to acquire a force of religion, and all that a religion demands. ... If you accept Marxism thoroughly, you have to logically accept Leninism, the Party and the Comintern. We stand for complete application of Leninism to the Indian conditions'

(Vol. I, p. 119). When the identity of a Marxian was defined in such unequivocal terms, the leftists were compelled to be fanatical ideologues, crusaders, because only their faith in Marxism as a religion, as an ideal way of life, was the sole criterion of their leftist identity. Their blind faith, further electrified with emotional charge, infused a kind of dogmatic quality of an irrevocable doctrine in Lenin's colonial theses and metamorphosed them into an ideology. When ideals are no longer relevant, they naturally do not hold (attract) you, your faith in them totters, and yet you are required to blindly believe in them for whatever reasons, the only way-out is to ideologize such ideals, then you are now held (controlled) by them unquestioningly [Bhargava, 1995, p. 333]. Aversion to compromise formed the second ideological constraint of the Indian Communists. With such 'determinist conception of the world', they conceived *reality* as 'a static immobile category', and failed to perceive *effective reality* which was: 'No class or group could fruitfully reject compromises and internal adjustment in face of the common enemy-imperialism' (Vol. I, p. 38). In the Indian conditions, the ideology of a free, united nation was more appropriate to rally people round than the Marxist ideology of a classless society. No wonder, the Communists were marginalised.

The Communists believed that since the conflict between the 'left' and the 'right' was in reality a conflict between two mutually exclusive paradigms, the strategies based upon them, in turn, demanded different styles of politics, methods of struggle and forms of mobilisation. 'Violence' and 'non-violence' were only the symbolic names for the contending strategies which were linked to the process of crystallisation of alternative leadership at various levels (Vol. II, p. 268). For the Communists, *peaceful force* was incomprehensible, *force* always denoted *armed violence*. This was yet another of their theoretical constraints. Propagation of non-violence was deemed treachery because 'the social reason behind this theory of non-violence (was) merely the anxiety for the vested interests of the native upper class and the apprehension of losing the

problematical support of the rich' (Vol. I, p. 177). It further distanced them from the leftist groups in the INC. They failed to see the reality that radical, violent overthrow of a state was relevant only in an absolutist state, like Russia, and not against the semi-hegemonic colonial state.

Roy was skeptical about the validity of some of Lenin's theses from the point of view of existing conditions in India. Yet, he faithfully upheld Lenin's other basic postulates. Thus, 'the 'Royism' that Indian Communists often tried to counterpoise to 'Leninism' actually cohered together in their shared Marxist logic of the insurrectionary paradigm *a la* State and Revolution' (Vol. I, p. 60). Such Bolshevik paradigms, ossified because of Stalin's deification of Lenin, were not only obsolete and incompatible, but misleading too, as they 'were expressed purely in economic terms, ... devoid of any conception of the varied political nature and specific form of colonial states in different countries, ... (and incapable of) evolving a political strategy and forms of effective struggle that could undermine a modern hegemonic state' (Vol. I, p. 60). The shrewd, semi-hegemonic colonial state perceived neither 'the Communist Party of India, consisted of a handful of individuals', nor the nationalist revolutionary militants as a matter for disquietude but '(t)he tendency for these two movements to draw close was seen as a very real threat... for in aiming at the overthrow of government they (were) closely linked' (Vol. I, Pp. 127-128). Therefore, the state propagated that the long-term goals of the two movements were deeply antagonistic and tried to discredit their common platform- the League Against Imperialism.

The fate of the Communists with regard to workers was also sealed because the colonial state was able to easily isolate the Communist-led revolutionary trade unions apart from the other trade union groups, because of the formers' 'militant methods of conducting the agitation and strikes and above all their diatribe' against the latter and also against the INC (Vol. II, p. 108). Yet any policy or action against the Communist-led revolutionary trade unions, in order to be 'legitimate', had to be 'justifiable'. So

long as there was no interference with administration nor 'hatred of Government as such' was preached and excited, activities of the trade unions were allowed. 'The colonial state was categorically interested in separating ... the genuine demands of workers from all political alignments', in order to minimise problems of maintenance of law and order and, thereby, to serve the state's long-term interests in India better (Vol. I, p. 64). It also sought to gain control through appointing commissions and through legislating laws that offered concessions to the working class. Small reforms and economic concessions were its clever moves to retain the trade unionism apolitical, neutral in the anti-imperialist struggle. Not only constitutional or reformist trade unionism was allowed but, '(e)ven the Communists who openly declared their intentions of forcibly overthrowing the colonial Government were allowed to function in the Trade Union movement to the extent to which they were perceived to be expressing the genuine grievances of the working class. ... (The state thus provided) the space of legality within the framework' of its oppressive apparatus (Vol. II, Pp. 38-41). But no narrower, insurrectionary forms of struggle were allowed. This was a tough challenge for the Communists, completely beyond the scope of their framework. They had to choose 'between waging a primarily political and therefore anti-imperialist national struggle or getting bogged down to economism' (Vol. I, p. 95).

The Communists reduced the national movement of the INC to bourgeois democratic revolution. They felt that consequently the Indian 'society as a whole could only be imbued with democratic ideals' and political equality, not economic and social equality. For, 'the level of consciousness of amazing psychological change did not represent a socialist consciousness but an awakening of democratic aspirations .... (However,) the remaining task of developing this consciousness further could not be performed by the socialist/Communists' (Vol. II, Pp. 143-144). Why? The pursuit of alternative 'channels' by the Leftists 'mobilised the peasants and workers

against the right wing and ultimately the INC' without 'leading them anywhere', and thus 'led to disunity not only within the ranks of the INC but also within the various left groupings' (Vol. II, Pp. 280-281). Had these Communist ideologies, constantly under the illusion of Lenin's colonial theses, been further matured into zealots like Stalin, perhaps the course of history in India would have been altered. For, a zealot is conscious that his ideology is dead. He has no illusions about it. 'He is moved by an earthy desire for power and by a grievous sense of real or imagined hurt, the characteristic stance of the victim, of those who are left out, .... He is a robust political realist, cynical and instrumentalist: cynical of all existing ultimate ideals, uninhibited in his use of any means to achieve his purported goal and well-versed in the cunning and deceit of political games' [Bhargava, 1995, p. 334].

#### *War for Organising a Dominant Communist Movement*

The questions central to the Communist movement in India in its formative stages were: (a) the 'first and foremost task' of forming a Communist Party; (b) the organisational nature, legality-illegality, of the Party; (c) the theoretico-ideological conceptions underlying the Party; and (d) the Party's attitude towards the INC as well as the Communist International. A legal mass apparatus was obviously essential for the Party activities. Since the colonial state would have never permitted the open preaching of a communist programme in India, the mass legal wing had to be a different body but 'under the control and direction of our own party (Communist Party) which cannot but be illegal' (Vol. I, Pp. 61-63). Hence, loose organisations within the INC, known as the Workers and Peasants Parties (WPPs) came to be organised between 1926-28 in various provinces of India, even when the Communist Party remained virtually non-existent. The WPPs represented a natural development of the left trend in the national movement; for the first time, an alliance between the labourer and the peasant materialised, apparently with

extraordinary ease. Their members entered the various committees of the INC and their increasing influence and popularity vindicated *the politics of transformation* followed by the leftist groups within the INC (Vol. I, p. 85). Yet, the INC maintained 'not only political but also organisational unity against imperialism' (Vol. I, p. 176). On the contrary, the Communists were convinced of the need of pursuing *the politics of alternative*, that is, 'the organisational victory of a separate, independent left party and a popular armed insurrection were an imperative necessity' (Vol. I, p. 33). Initially, Roy had conceived the WPP as the mass front of the Communist Party, a camouflage for its activities which the government would never allow. However, in the absence of an organised working class and its strong movement, any party built for implementing the minimum programme of the Communists had to represent the interests essentially of the petty-bourgeoisie, peasantry and the proletariat in order to be relevant to all sections of the society. Naturally, such a party had to be at best 'a radical petty-bourgeois party' (Vol. I, p. 64). 'But the correct programme for any Marxist had to be the abolition of capitalism and liquidation of landlordism', with complete expropriation and without any compensation- not abolition of landlordism by indemnification as the Left in the INC advocated (Vol. I, p. 112). Thus, 'the very logic of the growth and expansion of the WPP would militate against the organisations (the WPP and the Communist Party) being closely identified with each other. As various sections of society would be drawn into the WPP transforming it into a mass party, there was bound to be a conflict between the democratically elected leadership of these sections and the illegal Communist organisation' (Vol. I, p. 64). The Communists-to-be, perhaps therefore, rejected these Royist formulations and strove for forming a *legal* Communist Party. The Communist International too ruled in favour of the dissolution of the WPPs. At the Kanpur Conference in 1925, described as the 'First Indian Communist Conference', no dichotomies were noticed. But the 'sectarian political understanding of the

Communists', who made 'no attempt to reformulate the premises of received Marxism in the light of their own experience', sparked off sharp demarcation between them and the contemporary leftist groups in the INC (Vol. I, p. 105, 117). Because of their 'mechanical transference of the conceptual framework of the Russian Revolution', the Communists could never solve the dilemma: 'If the growth and political effectiveness of the Communist Party required the necessary mediation of a National Revolutionary Party, then how could the CP exercise the initiative to form and then control the mediating organ? ... In spite of their political radicalism, the petty-bourgeois masses will not enter into the party of the working class. Nor is it desirable that the working-class party should be flooded by the petty-bourgeois' (Vol. I, Pp. 346-351). '(I)t is futile ...to rely on one agency of oppression (the bourgeoisie) in order to fight the other' (Vol. I, p. 57).

Ultimately, faced with a tricky situation of their own making, some of the Leftists gave up their *Alternative Politics* and took to *Politics of Transformation* with its two-track mutually compatible policy of strengthening Congress as well as organising peasants and workers and, thereby, radicalising in general the Congress politics from inside. Although a nation-wide phenomenon, it was really successful in Kerala. A comparison of policies followed in Kerala and Bihar is expounded in the second volume (Pp. 285-293). The post-Independence developments in the two states clearly stress the advantage of adjustment and compromise in gaining hegemonic influence, as in Kerala the Communists could come to power and form a government more than once, whereas in Bihar never. However, the staunch Communists, who were 'committed to a form of Marxism which could not give (them) any clue, let alone guide', failed to respond successfully when 'called upon to make a breakthrough in Marxist theory', and were completely disorganised and scattered (Vol. II, Pp. 303-306). In the ultimate analysis, they remained silent spectators to the national movement ending up

'under the hegemony of bourgeois or capitalist developmental perspective' [Pantham, 1995, p. 112].

#### TRIANGULAR CONTEST FOR SOCIO-CULTURAL HEGEMONY

The basic theoretical premise in the third volume revolves round the definition of culture. Culture is defined in this volume as comprising both (i) an arena for contest among competing groups to define the cultural complexion of the society, i.e., the symbols and their meanings as perceived by the society, and (ii) 'a process inevitably involving contradictions, conflict and accommodation' (Vol. III, p. 11). It is difficult to guess what this jargon exactly implies, but taking this definition as a cue, the authors review the triangular contests for cultural domination in the medieval and the colonial period. As already mentioned, the three contestants are the ideologues of the two communities, the Hindus and the Muslims, and the state. Later on, the contest is among the protagonists of Muslim nationalism, Hindu nationalism and the so-called culture neutral, liberal, secular nationalism.

#### (i) *Culture as an Arena for Contest for Power*

The concept of power is never exhaustive with just military, political, economic or even social power. Rule by conquest is untenable, as the old saying goes, respect must be commanded, it cannot be demanded by those in power. Force, wealth or status, in order to be acknowledged as a power in a given society, 'must be encompassed within a predominant or primary value or ideology' (Vol. III, p. 80). People over whom power is to be exercised must accept readily, internalise the ideology and values invoked and evoked by those desirous of wielding power. Ideologies and values provide the bonds between the ruler and the ruled. The state always makes use of such bonds, in order to attain a sense of closeness between itself and the society it rules, and thereby, to achieve its ultimate goal of evolving a peacefully functioning stable economy and polity. Culture provides the basis for the growth of ideologies.

A particular cultural system comprise religious, racial, linguistic, ethnic and such other civilisational mores as well as a temper of its own personality, that is cultural consciousness. People belonging to one culture act or lead their life in a particular manner. It is different from that of people belonging to another cultural system. Within distinct cultural systems, different cultural motifs or patterns, traditions and practices exist which people share with each other within their cultural enclosure. Their behaviour and way of life being readily manifest, demarcate and act as an obvious boundary with other cultural groups. 'Various social segments retain an inclusive-exclusive world-view that can be condensed into the symbols of a particular culture ...: idol worshippers or idol breakers, cow killers or cow protectors, proselytisers or polytheists' (Vol. III, p. 79). So long as plurality of practices is tolerated, accepted as a fact of life, it is not necessary to actuate cultural awareness and focus on cultural dissimilarity, but when contests for power and hegemony ensue, it is necessary to do so. For, '(c)ulture has ... to do with a sense of self-esteem and self-worth as symbolic power in society and it is this that is addressed by those seeking to evolve hegemonic patterns of rule' (Vol. III, p. 75). And ideology, an ordered system of cultural symbols, serves as a channel. '(T)he materials of past experiences and moods are selectively arranged and built upon. This constitutes the process of recasting a culture into an ideology- .... It is not something false or unfactual', but a reconstruction with a changing perception, mentality (Vol. III, Pp. 19-20). This deliberate representation 'is not so much a distortion as an objectification of people's consciousness' (Vol. III, p. 33). Such reductionist attempts are designed to serve, pre-eminently, the interests of power and control. Thus, culture becomes an arena for contest for power.

Yet, 'why should the psychic order or disorder of people *en masse* express itself through a particular selection and arrangement of historical memory'? (Vol. III, p. 23). 'What in mass, popular culture and elite culture resonates and wins the allegiance of both to a common ideology'

(Vol. III, Pp. 30-31)? In the authors' perception, cultural memory is an essential part of the cultural Self and Being. The world-view of dominant groups in society- the cultural elites and the ideologues- forms the main ingredient of cultural memory. It is projected in the ideology of cultural tradition, prestige and inheritance. Naturally, the mutual animosities and thrust for power and domination on the one hand, and cultural defence and resistance on the other, are constant features not merely of the ideologues struggling for cultural hegemony but also of the masses. They are just dormant but not absent at the popular mass level. The symbiotic relationship reflected in the daily life of the people is a strategy for mutual coexistence and survival. Their relationship is not free of tensions. 'Consequently, the battle for cultural hegemony ... can activate, through specific constructions and articulations, the tensions... among people' (Vol. III, p. 78). That is why a particular ideology can effectively transform a prevalent, personal neurosis or a private mood into a public possession, into a powerful social force, a social fact. It draws its power from its capacity to grasp, formulate and communicate cultural perceptions and the mood of the masses accurately. Without doubt, the cultural ideologues, being the most active contenders in the struggle for hegemony, stimulate the imagination and activate deliberately the 'memory' of the culturally elastic powerless majority, by energising the promises of fantasy through a symbolic assertion of cultural power and resentment at its symbolic violation, e.g., hoisting on the Independence and Republic Days the national flag on a municipal ground used for prayers on Fridays in Hubli. Nevertheless, 'complicity in this construction and reconstruction is offered by those whose 'cultural memory' is being activated and restored' (Vol. III, p. 86).

Furthermore, whenever a sense of grievance emanates in a plural society from almost any disparity, such as political, economic or social inequalities, culture metamorphoses itself into a site of confrontation. Feelings of hurt, usually nursed by leaders, bring up social pressures. They comprise the substance of conflict in society.

Resolution of grievances is a matter for negotiation, and the context of these negotiations is at a higher structural level than the grievance itself [Crook, 1980, p. 395]. The principles, rules underlying such cultural contestation may be invisible, but they form the necessary trigger for social-cultural interactions. The concept of culture as elucidated here may baffle the lay reader.

## (ii) *Culture as a Process Involving Conflict and Accommodation*

The definition of culture as a process could be interpreted that culture is not something static but a dynamic way or code of life, constantly in flux, influenced as it is by different cultural groups who contest for domination. The authors define cultural power not as an institution or a structure, but 'a complex strategical situation in a particular society' (Vol. III, p. 79). With plurality of cultural groups in a given society, struggles for cultural power are most likely to arise. They are 'about power, about the right to define things, to impose a moral vision, to make institutions reflect what ought to be' (Vol. III, Pp. 152-153). In brief, they are attempts to impose upon society a definite identity, a way of leading life, a particular world-view, also certain cultural consciousness of how things at the bottom are and how people should, therefore, act. Their object is to imbue the society with unity, to construct a monolithic cultural entity for the real 'we'. A continuous definition and redefinition of the 'we' is at issue, where we were in the past, now are in the present, and want to go in the future. After Independence, we the people of India are going through such struggles, in order to emerge as a nation. On the one hand, nationalism is defined as integration and assimilation of all Indians belonging to different cultural heritage. It is advocated under the banner of *Hindutva*, which the Supreme Court of India has repeatedly defined as 'the way of life of the people in the sub-continent' [*Bal Thakeray v Prabhakar Kunte and Ramesh Prabhu vs Prabhakar Kunte*, Civil Appeals Nos. 2835 and 2836 of 1989 decided in 1995]. On the other hand,

minorities want to maintain their separate identity. Equality and liberty, being the bedrock of our Constitution, it is necessary now to determine what is our way of life, in what aspects of life we want to be equal, similar and to what extent we desire to protect our individual or group (community) freedom and identity. The contest goes on. However, the whole purpose of cultural contests, encounters and confrontations is not to annihilate any group but to establish power relations. Especially, the stronger must keep alive the weaker contestant as a sign of his own strength and power. They need each other economically also. Hence, self-restraint, collective euphemisation and tacit acts of complicity are employed by contestants to prevent making the struggle too costly for mutual survival (Vol. III, Pp. 354-358). Cultural resistance 'is a sort of clandestine, undeclared war beneath the surface.... a quiet piecemeal process where the aim of those who are struggling to survive is to work the system to their minimum disadvantage. ... a permanent conspiracy of ... the weak against ... (the) strong' (Vol. III, p. 148). Further, there is collective concealment of power relations, a historical process which often makes a virtue of necessity. 'Necessarily so, as everyday life and everyday order is only possible by the concealment of power relations' (Vol. III, p. 85).

'Most of the time cultural contests and assertions take place through symbolic practices, rituals and displays' (Vol. III, p. 178). The challenges and counter-challenges, as well as the assertions and violations of power, are communicated to the other side in various stylised ways. Building for the collective (cultural group), financing processions and feasts, etc., are a form of confrontation and contest- demonstrating the honour and resources. Such cultural activities prove that the group is of consequence in society at large, signify the group's capacity to preserve its 'land' and honour and, in particular, the honour of its women in contests of honour. Yet, 'strategies whose objects is to conserve or increase the honour of the collective are dictated by vital interests. This fact lies at the heart of cultural power struggles. For instance, the Mughal grants

to Hindu temples could be perceived as giving and receiving 'honour'. Yet, thereby the Hindus were obliged to show *respect* and *obedience* to the political power of the Muslims- which were material gains brought about through symbolic exchange. Further, symbols are useful in contests because they 'continue to be the well springs of emotional energy and a storehouse of passions' and 'provide templates or blueprints for the organisation of social and psychological processes' (Vol. III, p. 182, p. 351). 'It is these symbols which ... provide the ballast for movements of cultural assertions of the 'self' vis-a-vis the 'other' (Vol. III, p. 79).

By ignoring the cultural contests between a heterogeneous mass, the intellectual elite remains unaware of the politics of meaning and of symbolic power. The notions of 'collective power' and 'collective humiliation' make no sense to them. They offer simplistic explanations- divide and rule policy of the rulers, manipulative practices of communal leaders or chaos of zeal and prejudice- which leave passions to flourish in the dark and obscure the truth that 'the political processes of all nations are wider and deeper than the formal institutions designed to regulate them; some of the most critical decisions concerning the direction of public life are not made in parliaments and presidiums; they are made in the unformalised realms of ... the collective conscience or consciousness' (Vol. III, p. 352). 'It is a truism that communities, classes, nations, groups and, in the case of India one might add, castes have fought and competed for control over jobs, positions, money and resources. But one can also say that they have fought one another not about jobs and positions, but about honour. ... the reality (exists) of communities or castes that impoverish themselves in their efforts to maintain their honour' (Vol. III, p. 82).

Cultural memory restores the awareness of the difference, the dissimilarity between cultural groups and creates a sort of divide. The authors call this divide the *cultural faultline* between two communities. They explain that a 'cultural faultline is not born of colour, creed, language, etc., but of 'blood' that is spilt in conquest or

sacrificed in defence' in the cause of power. The equation of power in a given society can be maintained through cultural hegemony only 'up till the point that it is challenged. Once, however, the challenge is mounted, power must either adjust to it or spill blood, thus producing a cultural faultline' (Vol. III, Pp. 77-78). However, the authors earlier claim that 'there is a continuity, not of religious opposition but of the *cultural faultline* which produced long-term tensions and resistance, despite accommodations' (Vol. III, p. 18). The authors do not analyse whether the faultline produce long-term tensions or the tensions resulted in putting forth a challenge and spilling the blood and thus created a faultline.

Within the above hypothetical framework the authors undertake to analyse the emergence of militant Hindu nationalism, also of equally militant mass movement of the Muslims demanding Pakistan, their interrelationships, substitution of pre-1920 composite communitarian ideology and politics with separatist communal ideology and politics of post-1920 and the role of the British in all these developments. 'The great radical ruptures and massive binary divisions (such as the Hindu-Muslim partition of India) can only be examined through cultural power relationships' (Vol. III, p. 81). 'The historiographical approach developed in this volume... looks upon the phenomenon of communalism/nationalism in terms of construction-reconstruction of long-standing cultural contests.... (The authors) prefer to characterise the so-called 'religious conflict' as civil strife and to interpret it as a process of cultural contestation. This characterisation is applicable to struggles between castes- in contests of elite and popular cultures- as much as to struggles between self-defining communities' (Vol. III, p. 17). Since there is a wide diversity of religious beliefs between the Muslims and the non-Muslims, historians tend to 'see the continuity of communalism as "religious conflict" and fail to observe that the negotiations of power relations were basically those of cultural power in society' (Vol. III, Pp. 18-19). One may not agree with the authors for the simple reason that it appears mere verbal hair-splitting to call the

Hindu-Muslim contestation in India as 'cultural' and not 'religious' contestation, when such ascriptive status as religion forms the basic core of contestation for hegemony, exerts the maximum ideological influence, is politically persuasive, and manages to lurk behind 'the collective conscience or consciousness' even in contests where one of the peripherals like language or rural-urban divide creates the dividing line between the contesting communities, e.g., pre-Independence contest between Sanskritised Hindi or Urduized Hindoostani, or the post-Independence linguistic reorganisation of the erstwhile East Punjab (Indian) and its ultimate division into Haryana and Punjab, or the recent demand for Khalistan, supported primarily by Punjabi farmers, who initially agitated for remunerative price for their grain. Also, the linguistic dispute between Kamataka and Maharashtra over the border between the two states, particularly over the town of Belgaum, usually incited riots between the Marathi and the Kannad speaking communities in the town on the *Rajyotsava Day*, i.e., on November 1, observed to celebrate the formation of the state (then Mysore) since 1956. For the last couple of years, the riots on this particular day have acquired a religious character, those between the Hindus and the Muslims [Deccan Herald, 1995]. It would be interesting to know why and how this happened.

'A set of 'religious' beliefs, like all belief systems denote a *specific disposition*, a preferred mode of experiencing the world, the self and the relations between them. This disposition casts a derivative, lunar light over the solid features of people's secular life' (Vol. III, Pp. 22-23). Our *specific disposition*, our 'preferred mode of experiencing the world, the self and the relations between them' is nothing but religious, when it is with reference to Hinduism and Islam. Otherwise, why should a cultural event like the movie *Bombay* invoke religious bitterness? Private religion, when it goes public, unquestionably becomes an amphitheatre for power-struggles, because 'all so-called religious rituals are cultural, when they go public', but even an event in public life, like hoisting a national flag, acquires



a Hindu ritualistic character in our country and alienates the Muslims. Why does it happen, if 'celebration of the cultural past, whether of Muslims or of Hindus, as a focus for self-esteem and concern for its greatness and for the possibility of its restoration in the present have nothing to do with 'religion' as such? The authors seem to confuse between 'religious function', which is private and separate from 'religious performance' which is public. 'In religious performance, religion is applied publicly to address problems that have emerged in other sub-systems of society but were not adequately taken care of there' [Gupta, 1995, p. 2204].

The authors themselves admit that the psychological imagery invoked by 'all self-consciously nationalist Hindus and Muslims' was based on two distinct religions, never on the common sources of inspiration because 'civilisational aspects of culture are primarily dependent on religion in our country, although what they 'spoke of was not religion as a coherent ideological system but the sum of cultural practices, a world-view, a habitus. ... (only) 'revisionism' and 'dogmatism' in all cultural-ideological systems ... always offer alternative ways of interpreting master-texts, the common sources of inspiration' (Vol. III, Pp. 27-28). The master-texts being religious texts have thus never been the same for both- Hindus and Muslims; only the revisionists and the dogmatists from each religion used the same texts through alternative interpretation and appropriation. Do the authors hope for a synthesis of these two revised interpretations, so that it could then serve as a unified, common source of inspiration for both, Hindus and Muslims? According to Gramsci, a hegemonic ideological system is cemented by a common world-view. This world-view includes ideological elements from varying sources, but its unity stems from its articulating principle provided by the hegemonic group. Articulation of such principle of the common world-view, which Gramsci calls a *hegemonic principle*, by all groups forms a 'unified ideological system, that is to say an organic ideology. ... Ideological struggle in fact

consists of a process of *disarticulation-rearticulation* of given ideological elements in a struggle between two hegemonic principles to appropriate those elements, it does not consist of the confrontation of two already elaborated, closed world-views' [Mouffe, 1979, Pp. 193-194]. Isn't Hindu-Muslim hostility of this latter type and not the former? Further, this could be one of the reasons why the Communists failed to articulate their class ideology as the hegemonic principle in India.

#### *The Medieval Period*

The authors trace the roots of the Hindu-Muslim communal divide from Islam's advent and conquest in India. The cultural faultline emerged with 'the rule of an alien group of people over a vast population which had its own traditions of religion, culture and philosophy. The indigenous civilisational life-styles could not but have attempted to absorb the newly arrived, even if they were rulers with strong convictions of their own. ... (From) the very beginning, the integration principle began to operate in a reverse form seeking to transform the conquerors into inhabitants. The task of obliterating cultural alienation was stupendous' (Vol. III, p. 163). It could never be achieved. Muslims in post-Independence India, who are really descendants of the original inhabitants converted by the conquerors, are also concerned not so deeply about their community's share in power, prosperity or progress as about their right to maintain their distinct identity. Maybe, that is one of the factors contributing to the existence of the *cultural faultline* even today.

Medieval social and cultural movements, like the Sufis, the Vaishnavas and Vithoba cults of eastern and western India, the Nanak and Kabir panths of the north and the Ramanandis aimed at obliterating 'the conflict and strife between cultures while incorporating 'religious' motifs across the cultural faultline' (Vol. III, p. 18). They 'preached the vision of composite culture but they certainly did not succeed in influencing vast sections of the population' (Vol. III, p. 193). As the studies of these movements point out, it was

not possible to deny or ignore the 'cognate perceptions of *us* and *them*, of the *self* and the *other* ... through ersatz syncretism', i.e., through such perfunctory simulation of harmonization (Vol. III, p. 18). Indeed, 'due to the attempts to smoothen the unequal power relations, the blurred edges of the boundaries between the communities wore the appearance of composite culture on the surface. This sometimes gave the impression as if the seething discontent underneath had acquired a state of tranquility' (Vol. III, p. 183). 'Over a long drawn period and under the overall umbrella of the central or regional ruler a complex system of power equilibrium between the communities came to be established in every region, city or *qasba* or village and was, over time, legitimised by local traditions. It was this balance of power which gave these cities and *qasbas* an overall distinct cultural personality leaving on them a stamp of 'Hindu' or 'Muslim' pre-eminence. ... 'The... symbols (like *Jizya*, demolition of temples and killing of cows) became potential signposts on this subterranean *cultural faultline*' (Vol. III, p. 183).

Also, 'the religio-political project which sought to create a social base for the new state through Islamisation was doomed to failure' (Vol. III, p. 168). For, the 'project had embedded in it ... a self-consciousness highly imbued with orthodox Sunni Islam and its traditions.... of dogmatic Islam. ... It consciously sought to achieve something impossible, i.e., a state of cultural distance and political accommodation simultaneously' (Vol. III, Pp. 163-164). However, some of the conquering Muslim rulers adopted a different approach towards the building of a state in India. They realised: 'In pre-modern societies, religion, politics and economics are inseparably linked' (Vol. III, p. 160). Hence, with a view to converting a military garrison state into a socially stable and broad-based state, they sought to differentiate themselves as an autonomous system only remotely linked to the religious faith. They broadened the scope of loyalty by primarily emphasising efficacy and rationality as the principles of new governance where the religious and ideological loyalties were given a secondary

place. Thus, they incorporated 'the religious susceptibilities, ambitions and opinions of the non-Muslim elites into the institutional structure of the state' (Vol. III, p. 171). Although the cultural environment remained suffused with Islam, it was sought to be defined a 'revisionist' Islam in terms of open-ended Sufism. Obviously, in those days a 'ruler could not do without a religious ideology to legitimise his actions but he could certainly choose the main motifs of this ideology, interpret it and give it an institutional direction' (Vol. III, p. 163). Perhaps *Din-i-Illahi* was an attempt to find a completely neutral, non-partisan legitimising ideology for the empire (Vol. III, p. 171). All the same, loyalty based upon the identity of outlook and ideology, which could have emerged only if the population was brought round to accept Islam, was always preferred to such loyalty to the state.

#### *The Colonial Period*

With the arrival of the British, the basic cultural premise of the medieval Indian state was replaced by a new state with different cultural premises. The myth of Mughal hegemony was sought to be defended in the revolt of 1857. Still, loyalty and common commitment to it were supplanted by a struggle for renegotiation of power relations of the indigenous communities between themselves through the new state apparatus. It was seen by both, Hindus and Muslims, as the alien rule of non-Hindustanis. 'Each community's discourse aimed at manipulating the state in its own favour while this need of the communities was manipulated by the new state in order to perpetuate itself. But each manipulative act/gesture of the community as well as of the state carried a price tag in political terms which had to be paid' (Vol. III, p. 193). However, certain pre-colonial elements prevailed in the colonial period too. They were: (a) the communal divide; (b) ideologues of the communities in search of authority; (c) state intervention; and (d) perception of 'us' and 'them', that is the Islamic and non-Islamic cultural enclosures. On the contrary, the focus of the ideologues shifted from influencing the ruler and

the ruling class to appealing to *our own*, to *us vis-a-vis them*, mobilising *our own*, solidifying the *we* of community,... and demanding recognition by the building of mass representation as a source of power.... The mutual relations of the ruler as the source of power for the ideologues and the latter as the legitimiser of the state disappeared. New political relationship between the ideologues and the masses had to be forged... within the democratic space, howsoever limited, that was engendered by the colonial state and institutions' (Vol. III, Pp. 350-351). The modernising discourse of colonial power questioned the religio-cultural practices in India. The arguments and appeals for re-invigoration of culture and tradition brought not a return to naive traditionalism but 'ideological retraditionalism'. The psycho-sociological strain of a new political system and a loss of cultural orientation 'sets the stage for the rise of new ideologies. They tried 'to historicise India's past and reconstruct a new vision of a glorious ancient civilisation..., an attempt to liberate the educated circles from the demoralising sense of inferiority.... Unconsciously or consciously the 'cultural faultline' entered into the visualisation and cognisance of this new vision...' (Vol. III, p. 294). The INC did not draw any line between the 'Hindus' and 'non-Hindus' and aimed at transforming Indian society from an amorphous mass into an integrated community with a sense of solidarity, by using the ideas of modern democracy to create. Yet, 'no organisation desiring to mobilise broad masses could dispense with its symbolic codes of communication. Jumping out of the cultural internality tantamounted to jumping out of one's skin and the Congress could not simply do it ... While for the Hindu Mahasabha the dividing line actually separated the 'Hindus' and the 'Muslims...' (Vol. III, Pp. 297-300). The Hindu Mahasabha thought essential to convince people that 'the survival of the Hindus as an effective people was possible only if from being a complex of innumerable social groups, they become a single social organism' (Vol. III, p. 306). Thus, two models of this solidarity were offered to the people- the soft, secular model which emphasised

the internal egalitarian reforms and the hard, dogmatic, communal model which exclusively stressed its external demarcation from the communities of Islam. Both competed within the broad internality of non-Muslims for being acceptable to the wider public in order to emerge as hegemonic. They should be visualised less as two distinct ideological currents but more as forms of articulation in varying accents. What differentiated one from the other was a shifting thin line of moods moving one way or the other to expand or marginalise one of these models. Again, to oppose imperialism, political expediency required not splitting the cultural internality of 'non-Muslim' space into secular and communal but marginalising the dogmatic Hindu discourse of monolithicity within it. Further, the Congress was visualised as a community of temporal interests and not of spiritual convictions, a sort of supra-community of the nationalism-inspired sections of all the Indian communities, Hindus, Christians, Muslims and Parsis who were expected to represent each other in discussions on public affairs and to avoid discussing matters opposed unanimously or near-unanimously by any community, like legal ban on cow-killing. However, due to the fear of being overthrown or rejected by their mass following, which came from their respective communities, the leaders continued to perceive themselves not as leaders of 'a composite new community', but still as leaders of their own communities. It was nothing but the awareness of communal divide which had led Gandhi to accept the fact that no Indian could become a popular mass leader of both the communities. The conception of the Congress as a united front of the communities was based on such wrong assumptions as the religio-ideological content of Indian nationalism could be completely purged of India's past history as it was remembered, and there were neither power relations nor any cultural contest going on along (religious) community lines. Thus, politics was not only separated from culture but culture itself was banished to the private realm. 'But the entire history of the freedom struggle shows that culture would always follow politics like the proverbial

elephant who is unable to get rid of its tail' (Vol. III, p. 303). The logic of the existing cultural schism was fully grasped (also) by the colonial authorities and they made it an instrument of their own perpetuation by institutionalising it in the form of separate Muslim electorate. It would be easier to follow, if the reader reads 'religion' and 'religious' instead of 'culture' and 'cultural' here.

Initially, the idea of Pakistan was viewed in rational terms an absurdity, a ploy, a sort of bargaining counter for something else. It was then considered as a dangerous solution lurking behind the minds. Finally, it was digested as the reality, an irreversible history, an inevitability. But it was the highest act of treachery and also vivisection of the motherland in the eyes of the Hindu Mahasabha which came into prominence during the last few years before Independence, on account of the policy of appeasement of the Muslims followed by the Congress on the one hand, and the aggressive onslaught of Moslem League on the other. The demand for Pakistan helped the Muslim League to become a sort of mass movement, whereas for the Communists, the protagonists of the trilogy, 'the so-called communal problem in India was really a problem of growing nationalities and it could be solved on the basis of the recognition of the right of self-determination, to the point of political secession of the Muslim nationalities, as in fact of all nationalities which have India as their common motherland.... (They accepted) Stalin's well-known definition: 'A nation is a historically constituted stable community of people, formed on the basis of a common language, territory, economic life and psychological make-up manifested in a common culture' (Vol. III, Pp. 332-335). They forgot that in spite of this definition, the U.S.S.R. was formed out of such diverse states as Armenia, Azerbaijan, Kazakhstan, Kirgizia, Uzbekistan, etc. Also, they overlooked the fact that 'in Soviet times, it was openly said among archaeologists and historians that 'it is our job to collect the facts, theirs in Moscow to draw the conclusions for us' [Sahanovic, 1995].

Historical myths, that concurred with the Communist ideology were established and popularised, although they contradicted with the historical facts. Religion had nothing to do with Stalin's definition of nationality. It was used to identify hitherto unknown nationalities of people as Pathans, Sindhis, Rajastanis, Gujaratis, Bengalis, Punjabis, Assames, Biharis Oriyas, Andhras, Tamils, Karnatakis, Maharashtrians and Malayalis. 'But one wonders how the above definition was used to argue the partition of two nationalities, i.e., Punjabis and Bengalis on the basis of religion.... The Communists cadre and all patriots were supposed to popularise the principles laid down herein.... In fact the entire analysis was an exercise in absurdity.... How does one explain the collective self-deception indulged in by thousands of people organised in a disciplined group' (Vol. III, p. 335)? In a self-congratulatory tone, P.C. Joshi wrote that Communists were able to work out the case for Pakistan better than even the Leaguers.

The Communists claimed their commitment to secular theories of supra-cultural notions of 'nation' which had nothing in common with the separatist theory of dividing India into two nations on the basis of religion. They pointed out that the cultural faultline appears to an enlightened reason in the form of prejudices, distrust and suspicion—a sort of communication gap which did not permit individuals as well as groups to understand each other's point of view. Nevertheless, they 'were lapsing into a language and praxis which took into consideration the logic of cultural internality' (Vol. III, Pp. 346). The authors term it 'cultural internality', when really it is internality based on religion. They accuse the Communists of being not aware of what they were doing, so wrapped up as they were in their own theories. Don't the authors too fall in a similar trap, to conform with Gramsci's theory of hegemony which always speaks of culture, ideology and intellectual and moral leadership, without hardly ever referring to religion? The authors assert that 'one theme that runs through the entire book is the inability of the *culture-neutral* discourse to grip the mind of the broad masses and

to constitute a genuinely composite people or composite nation' (Vol. III, Pp. 349-350)? 'The *Lakshman rekha* of the cultural faultline emerged again and again in the endless talks between the Congress leaders and Jinnah which both could never transcend to meet on a common platform' was definitely drawn on the criterion of religion and which ultimately resulted in partition (Vol. III, p. 303). Then why not call it secular or religion-neutral discourse? What does culture signify here, particularly, in view of the definitions of culture stated at the beginning?

'The *'habitus'* is the dynamic element of culture, the basis upon which we are disposed to order the symbolism available to us, through which the colours, shapes, sounds, words and so on *become* symbolic. In other words, 'symbolism of social interaction' and our 'spontaneous semiology' are coordinated through the *habitus*' (Vol. III, Pp. 116-117). Given the Indian (both Hindu and Muslim) psyche, no other but the religious element of the cultural system can be labelled as the *habitus* which imbues the overarching societal order with the temper of its own personality. The phenomenon of religious awareness *not* any other form of 'cultural awareness' develops into intense contests and is articulated not only in political situations but also in so innocuous contests as the hockey or cricket matches between India and Pakistan even now. The authors themselves inadvertently admit that the 'structural similarity or civilisational symbolism would be the *'habitus'* which would demarcate a cultural boundary vis-a-vis the culture inspired by Islam' (Vol. III, p. 116).

After Independence, the basic premise of our Constitution is the individual and protection of her/his freedom without discrimination on grounds of religion, race, caste, creed, sex, descent, place of birth or residence. India was never conceived as an amalgamation of communities- cultural or religious. 'However, erasing the category of community from the Constitution could not and did not remove it from the field of power relations in society. The power-seeker in a democratic polity could easily use community as a commodity to be purchased,

cajoled or coerced' (Vol. III, p. 353). Being aware of people's staunch caste ties and loyalties, they pander to the casteist and communal demands of their constituencies, in order to obtain votes during elections. Hence, the struggle for cultural hegemony continues as before, and few owe allegiance to the Constitution and its ideals. Still, pilgrimage to Haj at public cost continues, not so much out of religious fervour as for proclaiming their cultural-religious right to do so. In retaliation, Hindu pilgrims flock to Amarnath at public cost and, on a rare occasion, the *Babri* mosque was demolished in order to erect Ram temple. Symbols acquire more attention than ground realities such as poverty, illiteracy and gender-injustice. The power relations during the forty-five years of constitutional rule in India are still defined through cultural contests, not so many between the cultures of the two traditionally antagonistic communities- Hindus and Muslims- as between the elitist and the popular cultures of various caste denominations, since the *Dalits* and the other backward castes have been empowered by the special provisions accorded to them by the Constitution. Unlike the Communists who deceived themselves with the ideology of 'class' and every individual belonging to either the 'haves' class' or the 'have nots' class', the makers of the Constitution were not so enthralled by their ideals of the fundamental rights of the individual. They did recognise caste and religious distinctions and provided for the underprivileged castes and religious minorities enough protection.

#### CONCLUSION

Certain statements of the authors are quite perplexing, for instance, while elaborating on the cultural internality of communities, they state: 'The active organisation of communities in the sense of aggregations perceiving themselves as linked entities vis-a-vis the 'others' and in relation to political and official authority, existed in India since centuries.... each of them (communities) related to the internality of one or the other wider cultural conglomerations- the Hindu and Muslim cultural enclosures.... when the larger collective of internality in the Hindu cultural enclosure and

its ethical world was invoked, the faultline between it and the internality of the 'other' Islamic culture would become visible' (Vol. III, Pp. 75-77), whereas while analysing the cultural complexion of the nation during the colonial period the authors come to the conclusion that 'the Hindu community, still *non-existent* in fact had come into existence in the form of a cultural construct at the end of the nineteenth century, The translation of that idea in the realm of practice was the mission undertaken by many organisations for the Hindu fold' (emphasis added) (Vol. III, p. 306).

Further, the blood spilt profusely during the disturbances in Punjab is understood as one 'example in modern times. ... The cultural faultline in these examples tends to foster permanent civil war' (Vol. III, Pp. 77-78). Isn't it too soon to correlate the centuries-old antagonism between the Hindus and the Muslims with that between the Hindus and the Sikhs? Violence and AK47 guns being the creed of the younger generation, and also 'violence being as Indian as the mango pickle', killing and spilling the blood is an every-day routine. Does it give rise to a *cultural faultline* on every occasion when blood is spilt? Again, the authors maintain that a caste hierarchy of cultures and its relations of power were established and maintained without bloodshed, not coercively with physical force, but through Brahmanism, 'an ideology of social-cultural power, which is convertible into economic-political power' (Vol. III, Pp. 77-78). Does it indicate that there existed no *cultural faultline* among the castes, particularly the *Dalits* and caste Hindus- *Avarnas* and *Savarnas*? The post-Independence caste riots do indicate not only the rejection of Brahmanism but also the existence of suppressed feelings of animosity. Further, the question arises how to explain the process of Sanskritization with the help of such deconstruction? Also, was any sort of *cultural faultline* between the Hindus and the Christians actuated, when the Portuguese arrived in Goa and the British in other parts of the country?

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## BOOK REVIEWS

Oldenburg, Philip (Ed.), *'India Briefing: Staying the Course'*, India Briefing Series, 8, Deborah Field Washburn (Series Ed.), The Asia Society and M. E. Sharpe, New York, 1995; Pp. x + 242, Price: \$ 18.95.

This Volume is the eighth in the Series intended to provide an update on India, both factual and by way of interpretation of contemporary events. Attention is focussed on selected facets of the political economy of the country which are of current or potential importance in the emerging scenario. For the Volume under review, the major themes are those relating to State politics and the Central policy of economic liberalisation. State politics is viewed through the developments in a single State, namely, Gujarat, which is treated as an epitome of the politics of the nation. All the main features of Indian politics today, such as communal antagonism and violence, the demand for the advancement of backward castes, the problems of environment and development and the criminalisation of politics, manifest themselves in the State of Gujarat. They have to be tackled by the State Government functioning through democratic institutions. The electorate lends a helping hand by supporting or toppling governments through periodical elections. The recent defeat of the Congress and victory of the Bharatiya Janata Party (BJP) in that State is a significant expression of this process. John R. Wood, the author of the article on the subject, however, reads a little too much in the political process in Gujarat when he asserts that 'what Gujarat does today, India may have to do tomorrow' and suggests that at the ensuing Lok Sabha elections, the BJP may make it to the Central Government in the same way. He also points out quoting L.K. Advani that the defeat of the Congress in the 1977 Lok Sabha elections followed a similar course in Gujarat. But the argument does not appear to be convincing. The truth of the matter is that politics at the level of the State and at the national level are so closely intertwined that no single State can be said to pave the way for others to follow. Secondly, within limits, every major State can claim to be the harbinger of coming events. Even in the case of Gujarat as we know now, within a few months of the formation of the BJP Government it was faced with a serious crisis owing to the revolt of a

section of MLAs led by Shankarsinh Vaghela - a member of Parliament. The Chief Minister, Keshubhai Patel, had to step down from his office and a new Chief Minister was sworn in. Though the party was able to weather the storm, its vulnerability was amply demonstrated. The inclusion of the names of several leaders of the BJP in the recent 'havala' scam has also damaged its image and the electorate is bound to react to it when it is called upon to vote in the forthcoming parliamentary elections.

In another interesting article on State Politics, by James Manor, an attempt is made to demonstrate the complexity of the job of the Chief Minister of a State with special reference to two powerful and largely successful Chief Ministers, namely, B. S. Shekhawat of Rajasthan and Sharad Pawar of Maharashtra. The capacity of the Chief Minister to tackle the agitation of elements within the party and outside for a greater share in power, patronage and material resources of the State is continuously being tried and determines the chances of his survival in that office. On the whole, the country is throwing up the right persons for the job according to the verdict of the writer of the article. It deserves to be read in full for getting a feel of the variegated role that the Chief Minister is called upon to play.

On the national level two outstanding contributions are made on the progress of the new economic policy. Meghnad Desai in a brilliant study of the relations between economic policy and democratic politics in India shows how the former, howsoever well conceived, is stalled by political compulsions leading to its dilution almost from its inception. The ruling party seems to be in no position to create popular awareness of the reasons and effects of the new policy, leaving to the Finance Minister the unenviable task of ploughing a lonely furrow for its successful implementation. The Lok Sabha elections in the offing are yet another factor in its lukewarm pursuit. The new policy therefore is unable to take off from the rhetoric stage into positive action. Targets of containing inflation and deficit are being missed and uncertainty mars the prospect for the future.

The unhelpful attitude of organised labour to the new economic policy has been well brought out in another article by E. A. Ramaswamy. The article ably traces the history of the Trade Union

movement in the country and shows how it is still functioning in the old pre-Independence mould. As against the escalating demands of rival unions in the organised sector, more than 92 per cent of the total number of workers in the country are being exploited by labour contractors and other employers in the unorganised sector. Even the minimum wages laid down by law are not paid to them and child labour, bonded labour and women are badly discriminated against. New industrial undertakings are getting more and more capital intensive driving more workers into the ranks of the unorganised. Here again there is an absence of political will to bring about necessary legislative and other changes in the situation.

A commendable feature of the present Volume is the chapter entitled "Reading India" by A. T. Embree, giving sectionwise reading lists for those interested in knowing more about India, its history, people, polity, economy and society. The reading lists have been prepared with great care and are bound to be welcomed by India watchers.

The Volume is brought to a close by a fairly exhaustive chronology of important events during 1993 and 1994 followed by a glossary (for Western readers) of Indian names, etc.

The contributors are well-known Scholars and writers on India and their articles deserve to be widely read for the many insights they provide into contemporary politics and economics of India.

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*India: Recent Economic Developments and Prospects.* The World Bank, Washington DC 1995.

This is a World Bank Country Study prepared by a team of its officials after a visit to India and consultations with various government bodies and private institutions, including the Ministry of

Finance, Reserve Bank of India (RBI), the Ministry of Environment and Forests, the Maharashtra State Pollution Control Board and the Ministries of Finance of Maharashtra and Tamil Nadu. The study reviews the achievements of three years of the reform programme introduced in the wake of the liberalisation of the economy by the new government in July 1991 and examines the economy's response and prospects, including the response and prospects of private investment. It identifies the short and medium term policy issues facing the government and discusses the steps taken to address India's environmental problems.

The reform programme focussed on the investment regime, trade policies, the financial sector, taxation and public enterprises. Its major objectives were to reduce the capital intensity of India's growth process, lessen its reliance on the unsustainable expansion of the public sector and thus translate the country's relatively high investment rate into high and sustainable growth of output and employment. It also aimed at reducing the serious fiscal and external imbalances faced by the country which had generated double digit inflation and led it to the verge of defaulting on its external debt obligations.

When Mr. Narasimha Rao's government assumed power the economy was facing low growth, a decline in agricultural production and stagnancy in industrial production, a double digit inflation due to a large fiscal deficit, a large balance of payments deficit and an extremely low level of foreign exchange reserves. As a result of the reform programme, the change that has occurred between 1991-92 and 1994-95 is as follows: Gross Domestic Product (GDP) growth increased from 0.9 to 5.4 per cent; agricultural production from 2 to 2.2 per cent and industrial production from 0.6 to 8.0 per cent. Gross domestic investment fell from 23.6 per cent of GDP to 20.4 per cent in 1993-94 and gross domestic savings from 23 per cent to 20.2 per cent. The rise in the wholesale price index was 13.6 and 11.5 per cent, respectively, and in money supply 19.4 and 18.6 per cent, respectively. The gross fiscal deficit was 5.9 and 6.0 per cent of GDP in the two years and the current account deficit -0.4 and -0.1 per cent. Foreign exchange reserves rose



from \$3.58 bn to \$19.6 bn.

It will be seen from this that the reform programme has yielded results in certain areas, but has not in certain other areas. While the growth trend has been raised, investment and saving have declined. Inflation continues to trouble the economy because money supply continues to rise at fairly high rates. The gross fiscal deficit continues to remain at uncomfortably high levels contributing to inflationary pressures in the economy. On the other hand, the balance of payments is much more comfortable and foreign exchange reserves are unbelievably large.

Agricultural growth has been the result of a continuous run of good weather during this period. Industrial growth has been the result of the number of liberalising measures adopted by government. On the other hand, the fiscal situation continues to be a matter for worry. The gross fiscal deficit continues to be higher than what it should be (3-4 per cent of GDP). Although efforts have been made to raise revenue by reducing direct and indirect tax rates and rationalising the tax system, the effort to cut down nondevelopmental expenditure, such as interest charges, subsidies and losses of public enterprises, has not been as much as is needed. The state governments' gross deficit continues to be at a disturbingly high level of 3 per cent of GDP. The balance of payments shows great improvement with exports rising to a level of 90 per cent of imports from an earlier level of 66 per cent. The increase in reserves has been largely due to portfolio investment rather than to direct investment in the Indian economy.

The study generally endorses the measures that constitute the reform programme and commends the government's efforts to secure a consensus so that it can avoid a reversal of efforts due to a strong public reaction. Thus, 'in short, while several more years will be necessary to complete the process started in July 1991, and difficult reforms are yet to be introduced, the skill with which reforms have been introduced thus far has few parallels elsewhere and enhance the credibility of the reform process. Part of the government's success in articulating and implementing a coherent mix and sequencing of reforms stems, however, from the fact that the process thus far

has been driven by a few central ministries (Finance, Commerce, Industry) and the RBI. The full potential benefits of India's reform programme will only materialise if the process is extended to sectoral ministries, public enterprises and state governments, where the sheer number of players will make achieving a consensus and coordinating policy reforms a much more arduous task' (p. xx).

Notwithstanding the success achieved so far, the process needs to continue. In particular, India has to find in the short and medium terms a way of achieving greater fiscal balance and at the same time maintain the dynamism of an economy which has been historically driven by a fiscally unsustainable expansion of the public sector. This requires, according to the study, (i) an increase in public saving enabling the public sector deficit to decline while expanding public investment in areas where it complements the private sector; (ii) a re-evaluation of all ongoing or planned public investment projects to ensure that they are economically viable, are directed towards the most urgent investment priorities, and cannot be undertaken by the private sector; (iii) establishment of a policy framework conducive to private investment; and (iv) measures to offset the impact of capital inflows on the competitiveness of the real exchange rate to ensure continued expansion of exports.

The public sector accounts for investment of 10 per cent of GDP out of a total of 22-24 per cent. Three quarters of this is by public sector enterprises and the remainder by central and state governments. Since public savings are only around 2 per cent of GDP, such an investment is unsustainable. Public savings are so low because of increased current spending, low profits of public enterprises (PEs) and poor cost recovery of public goods and services. Improved public savings are therefore vitally important not only to restore fiscal imbalance but also to check the anti-investment bias of fiscal adjustment. This is possible only if wasteful expenditure, including poorly targeted subsidies, is reduced, tax administration is improved, there is better cost recovery, and PEs' claims on the economy's savings are reduced through restructuring and privatisation. Inter-state transfers of resources

also need to be organised in such a manner that while the poorest states get adequate resources for development, incentives are provided to everyone to mobilise and use resources more efficiently. However, public investment needs to be directed to productive projects that complement and stimulate private investment. A 'zero-based' evaluation of all expenditure programmes should be undertaken to eliminate those that are redundant, as proposed by the Ministry of Finance.

A recovery of private investment is necessary if overall growth is to be maintained. This can take place in the short run, if a policy and regulatory framework conducive to private investment in such sectors as telecommunications and hydrocarbons, in which there is strong private interest, and in agriculture and agro-business, which account for 15 per cent of total private investment, is put in place. In the medium term, removal of *de facto* barriers in sectors such as power, urban infrastructure and roads, ensuring public investment in infrastructure, and reduction of the size of the public sector deficit are important.

Another important aspect of the economy during these years has been the very large increase in foreign exchange reserves - from \$1.2 bn in 1990 to \$19.6 bn in 1994. Bulk of this inflow has been on account of portfolio investment - investment in Indian equities, Global Depository Receipts (GDRs), etc., - and very little on account of direct investment which liberalisation should have brought. In order to prevent an increase in the rupee's exchange rate, which would have hurt India's export effort, the Reserve Bank purchased the foreign currency and increased the money base in the economy and thus increased the possibility of inflation, particularly because the fiscal deficit is still high. The study argues that the best way to deal with this bonanza is to widen the current account deficit through an increase in investment. A reduction in the fiscal deficit and an increase in public savings are essential for this purpose. Since investment is sluggish at the moment, it might be desirable also to take steps to discourage such inflows, particularly volatile portfolio funds. The study specifically cautions against using these inflows by widening the current account deficit through an increase in

current spending by government because this will not lead to any increase in the export base through high value investment, which will be needed to service the larger debts.

The study presents a well argued brief on how to continue the reform process. The real question is whether the Indian political system will permit the implementation of some of these measures. As it is, the central government has found it difficult to reduce the fiscal deficit to recommended levels and raise public savings. Privatisation of loss making enterprises has been resisted by trade unions and has not been found attractive by investors. Secondly, the panacea of privatisation of roads, telecommunications and hydrocarbon cannot be made to work quickly because of the complex issues involved as the Enron and Telecom examples show. And as more and more such sectors are taken up for privatisation, the complexities are bound to increase and progress is bound to be slow, particularly when different political parties exercise power in different states. The study also pays no attention to the problems of unemployment that such privatisation measures entail. This is something which the system cannot ignore howsoever desirable the reform measures may be.

One of the fallouts of the reform process was to be a reduction in capital intensity of industry and an increase in the production and export of labour intensive goods. This does not seem to have happened to any great extent and the same items, which were exported earlier, continue to be exported at a steadily increasing rate. The emergence of large firms through mergers and take-overs, so necessary for increasing the competitiveness of Indian exports through realisation of the economies of scale, does not seem to have taken place to any great extent. Nor does foreign investment seem to have rushed in to source production for exports based on cheap Indian labour. If anything, foreign investment has flowed in mainly to profit from supplying consumer goods and consumer durables to the so-called 200 million strong Indian middle class.

This does not mean that the reform process has to be reversed. Further progress is going to be extremely difficult and, unless the Indian political

system displays a high degree of wisdom, the Indian economy may continue to voyage in shallows.

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Paul Krugman, *Development, Geography and Economic Theory*, Ohlin Lectures, 1992, M.I.T. Press, Cambridge (Mass), 1995, Pp. 117, Price: \$24.

The image of a dog going round and round in an effort to catch its tail came into my mind as I read this lucid book of Ohlin Lectures, 1992. That is the image of mainstream economics today. As the author argues, to be taken seriously in this stream 'the idea has to be *something you can model*' (Italics in the original). 'It is a subtle problem; indeed it is virtually impossible to explain why it is an issue at all to anyone who has not engaged in serious economic modeling' (p. 6). It certainly is a mystery not only to non-economists but to students of economics who have not been modelled or who refuse to be "modelled"!

The author contends that the very pregnant ideas thrown up by the high development theory of 1940s and 1950s- Rosenstein-Rodan's Big Push, Myrdal's circular causation, Hirschman's backward and forward linkages - as well as the valuable theories developed in economic geography - urban structure development, central place theory, etc., of Losch, Isard *et al.*, failed to make the grade into the mainstream of economics because of the inability of their creators to be explicit about the market structure - that is about the conditions of competition in the hypothetical economies that they were describing. Economies of scale are inherent and crucial to their arguments and therefore the modern sector in them will have to be imperfectly competitive. 'Unfortunately, there are no general or even plausible tractable

models of imperfect competition' (p. 14). This situation has not changed now but 'we now have a set of modeling tricks that allow us at least to present illustrative examples of economies subject to increasing returns' (p. 60). And the author proceeds to elaborate a model on these lines with a mere 27 equations.

He concedes that the whole tone of economics to many intelligent people seems strange and off-putting. 'On the one side, there seems to be a near-total lack of social or psychological texture - economists are notoriously uninterested in how people actually think or feel. On the other side, there is what appears to most people to be bristling mathematical complexity, with its accompanying strange jargon' (p. 74). But he argues against this that modelling is the thing and it can be done and is useful. First, such models can be built up. Second, they show the essential logic of high development even in a highly simplified setting. Third, the models reveal the sensitivity of conclusions to the assumptions. And finally, models tell us something about what attitude is required to deal with complex issues in economics (Pp. 82-83).

With such a weak defence the obvious question is why must economic reasoning be based on assumptions of self-interested rational behaviour? Why cannot it build models based on more realistic psychological premises, or on more historically based understanding of institutions? The author candidly admits that he does not have any fundamental answer to these questions (p. 77). That is the tragedy of modern mainstream economics. It has become a victim of a chosen technique of analysis in which it begins as a laden ship in the port of reality and ends as a random voyage in the blue seas of fancy. When will economics break out of its self-imposed stultifying mould?

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Roy MacLeod and Deepak Kumar (Eds.), *Technology and the Raj: Western Technology and Technical Transfers to India 1700-1947*, Sage Publications, New Delhi, 1995, Pp. 346, Price: Rs 365/-.

This collection of essays deals with the same field of studies on technology, technical education, technical transfers, etc., in India during the colonial period, that was tackled by two previous books reviewed in the October-December 1991 issue of this Journal. It contains papers discussed at the first Indo-Australian Conference on Science, Technology and Colonialism held in 1988 under the co-sponsorship of the National Institute of Science, Technology and Development Studies (New Delhi) and the Australian Department of Industry, Trade and Commerce, as well as some other papers bearing on the same theme. The essays are good and interesting.

The essays are grouped into three parts. Part I, 'The Transfer of Technology and the Raj', contains four essays dealing with agricultural developments in Uttar Pradesh, oilseeds in Madras and science and technology education in South India. Part II, 'Changes in the Means of Communication', consists of four essays dealing with the decline of Indian shipping, telegraph in India, building of India's railways, engineering education and the Public Works Department, 1847-1947. Part III, 'Towards Independence: Problems of Transition', comprises another four essays discussing technical education and industrialization during 1890-1915, National Planning Committee, 1938-49, Progressive Nationalist Scientists, and the Early History of CSIR, 1934-47.

The Conference broadly discussed 'the arrival, adoption, assimilation and in some cases - the rejection of western technologies' in India. Technology that came to India was not value neutral. 'British technology in India demonstrably had a "politics" and ... close relationship to political expectations' (p. 9).

The Conference focussed on 'structures underlying and fostering technologies which the British in India inherited and configured to their advantage, and which Indians gradually learnt

both to absorb and challenge in their vision of the future' (p. 13). 'Overall, it seems that (whatever happened at the local level), proposals to "generate" technological knowledge or to ensure its "integration" into "native" knowledge systems took a back seat at the level of colonial government policy. More emphasis was attached to "use" of knowledge than to its "transfer"' (p. 17).

This central premise is faulty on two related counts. First, it seems to assume a certain and invariant relationship between advance in scientific knowledge and advance in technology. That is more appropriate to the paradigm that prevails in the latter half of the twentieth century rather than to the one that prevailed in the nineteenth and the latter half of the eighteenth century. It is well-known that the 'so-called' industrial revolution in Britain in the latter half of the eighteenth century was spearheaded by technical advances in the cotton textile industry and the steam engine and both these were the work, not of scientists, but of actual workers in the relevant sectors who had no training in theoretical science. Scientific progress in Britain was at that time confined to astronomy, mathematical analysis, crystallography and magnetism, and these were not related to the technical advances that actually took place. On the other hand, French scientific advances in chemistry, engineering and thermodynamics at that time were more closely related to the technical advances that were being made in England. Yet the industrial revolution came first to England and much later to France. The celebrated steam engine of Watt and his invention of the condenser was once regarded as the product of the theory of latent heat but Watt's own testimony was the opposite. The fact is that the relation between scientific advance and advance in technology was much more loose and uncertain in the latter half of the eighteenth and the whole of the nineteenth century. The premise that scientific advance takes place first and then it is applied to industry has been long rejected by the historians of technology. Schmookler's study underlines the same proposition. In Britain there was no liaison between the scientists in the laboratories and the actual inventors in the technical field [Von Tunzelmann, 1981; Schmookler, 1972]. The whole paradigm

of that period was different from the current one. It is unfair and unhistorical, if not misleading, to judge the events of the nineteenth century in the perspective of the current paradigm.

The second related count is that the theory and practice of technical education in Britain was neither equipped nor experienced to transfer technical knowledge to India even if there was a desire to do so. The state of technical education in Britain at that time was nothing short of deplorable as compared to that of France or Germany. And it did not improve very much in the decades that followed. Britain's weakness in this regard persisted even to the World War II.

A telling example of this occurs in one of the essays in this collection on the origin and development of engineering education in India, 'Colonial Requirements and Engineering Education: The Public Works Department, 1847-1947' by Arun Kumar. 'The first engineering college in India was opened at Roorkee, in Uttar Pradesh, as early as 1847, at a time when Britain itself did not have a tradition of providing academic training to engineers. Indeed, as late as 1869, the very idea of a 'college for engineering' was utterly abhorrent to many British civil engineers' (p. 216).

And a footnote to this informs us: 'Except for military engineers, there was little academic training of engineers in Britain during the early nineteenth century. Indeed, the Census of 1841 did not include engineering as a profession' [Roderick and Stephens, 1972]. I hope that the scholars working in this newly opened field will take notice of these two related points and revise their framework of analysis.

A factual correction is needed of an observation of the editors of this volume in their introduction. They write: 'In fact, the government-induced railways in India were bolstered by a unique system in which the State guaranteed profit to private investors' (p. 14). In fact there was nothing unique, diabolical or colonial about the guarantee provided by the State in India to railway bonds. At that time, this method of financing railway construction was quite common in France and the United States of America where the federating states guaranteed the return on railway bonds.

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Joseph Valadez and Michael Bamberger, (Eds.), *Monitoring and Evaluating Social Programs in Developing Countries*, Economic Development Institute of the World Bank, Washington, D.C., U.S.A., 1994, Pp. xxviii+519.

One of the important aspects of the controversies relating to the Sardar Sarovar Project had been the method of project appraisal. The project appraisal reports were prepared by at least four groups of experts and it is not surprising that their findings are not in agreement. Lot of water had flown down the Narmada, the issues got diversified and possibly diluted but academically the questions remained as to what have been the major divergences and why? Economic Development Institute (EDI) of the World Bank has come out with this handbook dealing with minute details of Monitoring and Evaluating Social Programmes in Developing Countries. Two important aspects are made very clear from the beginning itself, that monitoring and evaluating are continuous co-existing processes, and that the criteria for such exercise will always be location-specific. In his foreword, Dr. Vinod Thomas writes that the volume incorporates a comprehensive review of the techniques evolved. The editors of the volume have worked on the book for about a decade, and of course the most crucial decade, when the methods of evaluation of social projects were under continuous scrutiny. The book is intended to be a practical guide to the policy makers, planners, project managers, researchers, trainers and students. One of the strong view points emerging in the recent past is that the methods used for evaluating economic

and infrastructural projects are not suitable for projects having larger social interface. Further, the development in the methods of evaluation have achieved commendable heights but still much remains to be done, especially in the context of less developed countries. There are a few handbooks and practical guides available in the recent past but most of them have focussed on a given problem, or cater only to the requirement of the donor agency. In this context, the present volume is an innovative and practice-oriented handbook keeping a perfect balance between the requirements of the evaluator and the existing field conditions. The authors have attempted to cover a larger span of issues and brought together the insights available from practical experiences. The volume is spread over in five parts and thirteen chapters, each part addressing to an independent set of issues keeping in view the intended readers. The authors claim seven distinct advantages of the book as against the existing literature. Among these, the issues incorporated in the chapters dealing with the organisation and utilisation of data base, evaluation of the project sustainability, estimation of project impact and the role of NGOs are quite important.

The evidence regarding project implementation indicated that, out of the 192 projects completed by the World Bank till 1985, about twenty per cent had unsatisfactory outcome. This fact points out to the hiatus between the *ex-ante* presumptions and *ex-post* achievements. There can be a large number of explanatory factors indicating the failure in attaining the intended results. But the inability of monitoring as well as concurrent evaluation to deal with these bottlenecks cannot be overlooked. About 100 countries have regularly established bodies for monitoring and evaluating the projects. However, effectiveness of such agencies in delivering the intended results is quite questionable. In other words, it is essential to evaluate the approach, methods, operational competence and output of such agencies in the recent past. I am afraid we are likely to come across most unexpected situations. In India, we have the Project Evaluation Organisation of the Planning Commission as well as the Project Monitoring Division of the Ministry of Programme Implementation to monitor and evaluate

projects. This reviewer has come across only a few studies from these organisations. The authors of the present volume under review have indicated the existence of such bodies and the work of monitoring and evaluation that is assigned to them in the developing countries. It would have been beneficial, had the authors commented upon the effectiveness of such organisations.

The twin concepts of monitoring and evaluation are discussed by the authors, keeping in view the practice as well as the policy maker's options. The authors preferred to call these two concepts by the acronym M/E instead of the M & E due to the plausible implication of the latter, that as if we are dealing with a single function. The argument is not convincing and M/E sounds more as *M or E* which is not the exact intention. A project management cycle is elaborated in the first chapter and the further discussion keeps in full view the components of the cycle, namely, (i) Identification and Preparation, (ii) Appraisal, Selection and Negotiation, (iii) Planning and Design, (iv) Implementation, (v) Evaluation of Implementation and Transition to Operation, (vi) Operations Management and Ensuring Sustainability, and (vii) New Project Identification. A feedback information process to allow the stage level iteration and internal consistency checks could have been incorporated here. The authors discussed the contexts of input-output monitoring, implementation of diagnostic studies and evaluation of project efficiency under four aspects, namely, (i) questions in the minds of the clients, (ii) kinds of studies, (iii) timing of the studies, and (iv) how the studies are used. The discussion is quite simple and client oriented. The section on the problems with current approaches to monitoring and evaluation includes a threadbare discussion of the major problems. Further, the authors also enlist some major inclusions under the recommended approach. Interesting among these, are the recommendations regarding involvement of the intended beneficiaries as well as NGOs and the additional emphasis on social analysis of the project. However, the possible pitfalls of these suggested changes should have been outlined.

Practical applications of M/E at the project level are discussed in the next chapter under the 'project

cycle' framework. The span of the chapter is quite large and utilises the experiences from the M/E processes in the developing countries. It is the common experience of the projects in the developing countries that in the process of going through the project cycle, need arises to go back to the earlier stage in the cycle in order to correct the process for some inadequacies. For example, if a problem is encountered while in the sixth stage of 'Management of Project Operations and Ensuring Sustainability', then there should be a possibility of correcting the procedure under stage four, namely, 'Project Implementation'. Such a feed-back, though implicit, is not discussed explicitly. The chapter includes the discussion about gender analysis to ensure full participation of women in project implementation.

Learning from the standard models is the theme of the next chapter which draws a great deal on the existing models in the literature. Many times, however, the new projects are not amenable for any common types of models and, therefore, either a new system analytical model or such other form has to be used. Table 3.1 of the chapter gives a lucid presentation of the most common approaches in social modelling. Among these approaches possibly Structured Learning should get priority and many times this is in the background of the process of understanding. Programme Information System for Strategic Management (PRISM), which was created by USAID in 1991, illustrates how a set of indicators can be formulated and used in the process of understanding to monitor the medium term objectives. Detailed steps have been incorporated for each model application. An interesting inclusion here is the four step method advocated under ZOPP (Zielorientierte Projekt Planung) by the German Development Agency, for ensuring beneficiary involvement. The construction of models has been illustrated by taking a few examples. The social programmes have definite goals and hypotheses which need to be tested keeping in view the activities, resources, outputs and inputs. The material caters to the need of researchers as well as practitioners.

Design and implementation of monitoring as well as evaluation from the perspective of

guidelines to the practitioners form the base for the second part. This part forms the major portion of the book. The part is spread over in five chapters. The discussion about major components of the system of monitoring in terms of information is made initially. Cost effectiveness for the choice of alternative programmes has been discussed here. Some discussion about the components of cost, especially in the case of social programmes could have been an added instrument here. This is followed by an indepth discussion of the diagnostic studies. The utility of the feedback information is underscored here. But one must make a distinction between a feedback from a diagnostic project as against the same from a wide ranging social project. Project sustainability has been one of the crucial points of discussion in the recent past. The World Bank's Operations Evaluation Department conducted a wide ranging study of the sustenance of the 557 initiated projects (completed and assessed between 1986 and 1988). The study revealed that only 291 projects from all the sectors sustained and out of these only 9 projects were in the agricultural sector. The sustainability was taken here to mean the capacity of the project to continue to deliver its intended benefits. Chapter six contains a valuable discussion on sustainability on the background of monitoring and evaluation of a project. Alternative approaches to quantitative environmental impact assessment have been discussed. A composite index of sustainability is presented demonstrating its use in a case study. The discussion involved here dealing with sustainability can be treated as one of the most important highlights of the book. Only a few studies dealing with monitoring and evaluating a social project could bring out the concept of project sustainability with such clarity and demonstrate its use. One point, however, which needs to be emphasised here is about the non-neutrality of sustainability to the existing institutional framework.

Chapters seven and eight concentrate on the methods of project impact analysis. After assessing the importance of the simple, rapid and cost effective ways to assess project impact, the authors present an experimental design of project impact analysis. Here the conventional designs

are compared with three major designs. The authors further discuss three important aspects, namely, (i) identifying intervention and non-intervention of the population, (ii) partitioning variation in types of intervention with intervention intensity, and (iii) creating protective barriers to control for the influence of external factors. The authors also discuss when and how to use these designs along with some examples. As mentioned above this part forms the major portion of the handbook and caters to the requirements of practitioners as a guide. A small summary (either descriptive or in a tabular form) at the end of the part would have been more beneficial.

Data collection for monitoring and evaluation has always been a challenging aspect for any social project. The discussion in part three, spread over three chapters, covers the qualitative and quantitative aspects of data collection. The part also includes a chapter on sample design. The chapters on qualitative and quantitative methods of collecting data for the purpose of evaluation, not only incorporate various methods of collection but also include the cautions against usual errors. The authors tried to cover a large span of the subject involved in the three chapters and, hence, some deletions were rather unavoidable. Some methods like Lot Quality Acceptance Sampling (LQAS) form a part of substantial discussion and it suits the requirement of the local managers. Part four of the book includes organisational and management issues in programme evaluation. The part has only one chapter which considers the organisation, location and operational details of the M/E programmes. While listing the issues affecting the utility of monitoring and evaluation, the authors have emphasised the way of organisation, potentially threatening nature of evaluation which destabilises the M/E system, little incentive to cooperate on the part of involved individuals, and lack of coordination between donor agencies. This list excludes two important aspects, namely, the existing dichotomy between evaluator and implementor (togetherness or antagonism), and the vertical as well as horizontal coordination of the implementing administrators (possibly due to the sectoral evaluation). The authors have given

some suggestions to improvise the national M/E system (key issues are put in an interesting manner in Box 12.2).

The last part of the volume includes a crucial aspect of 'teaching monitoring and evaluation'. The main participants in such training programmes include policy makers, planners, project staff, M/E agency staff, trainers, NGOs and donor agencies. Thus, the training components have to be properly mixed to suit the requirements of the groups. Very painstakingly the authors have included the course content of a 'stand alone' course as also the content of seminars/workshops. They have rightly emphasised the case study method, field visits and panel discussions as important components of the training. The chapter could have included some condensed exhibits from the earlier section, if this alone should help the trainers.

The volume is prepared for monitoring and evaluating social programmes in developing countries, keeping in view a large audience of policy makers, project managers, trainers and researchers. It begins with a review and extends to some of the practical issues in the field of monitoring and evaluation. The style of presentation is more akin to Structural Learning method and hence one can easily read the voluminous book up to the last chapter with ease. Through the use of informative tables, boxes, examples from the existing projects, the authors have brought together many facets of monitoring and evaluation. The volume would be of immense use to the groups which it intends to address, namely, policy makers, project implementing agencies, donors, researchers and trainers. In the present context we hope that the proper use of the volume would reduce at least the controversies which emerge due to the flaws in the process of evaluation. Finally the process of monitoring and evaluating is not free from the structural aspects of the project, therefore the process has to be essentially formulated keeping in view the project.

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V.V. Singh, *Communal Violence*, Rawat Publications, New Delhi, 1993, Pp. 184, Price: Rs 225/-.

Dr. V.V. Singh, a Superintendent of Police at the time of writing this book, himself says that 'the present study does not attempt to discuss everything relating to the problem of communalism but has touched one specific aspect, namely, communalism *vis-a-vis* the police (p. 14). The subject of discussion is thus the violence part of communalism. Here also the author admits that the role of the police is only a symptomatic treatment of the problem.

Though the perspective of the study is thus limited, the author gives us a bird's eye-view of the theoretical constructs of communalism and of related issues as put forward by several writers. He finds that these are only generalisations and do not fit in with the ground realities of communal conflicts. He certainly has a point when he says that the people who bring about communal clashes cannot be identified as belonging to a particular Marxist 'class'. On the basis of his study of ground realities, the author has formulated certain hypotheses which, in short, are as follows: (i) Communal conflict has its roots in the polarisation and clusterisation of the city's inhabitants. More the polarisation, more the intensity of the conflict. (ii) The potency of a group to engage in violence is one of the determinants. (iii) Communal riots have multiple causes, including deep-seated rivalries.

The author then discusses what is polarisation and cluster-formation. Polarisation is the emergence of a 'We' - 'They' syndrome on the basis of religion, language, caste, occupation, etc. It leads to cluster-formation in the course of the growth of urban centres which, in turn, further accentuates polarisation. These, together with clashes of economic interests form the material which is worked upon by the leadership. The author has referred to various existing studies of this phenomenon and of the development of riot-prone structures and riot-prone situations.

The hypotheses already formed are then tested through a study of the riots in Uttar Pradesh. Three cities have been studied. Aligarh and Moradabad, where many riots have taken place, and Rampur,

where in spite of its vicinity to Aligarh and Moradabad and in spite of many similarities in socio-economic conditions, no riots have taken place. Aligarh and Moradabad have been termed as the 'experimental' samples, while Rampur has been termed as the 'controlled' sample.

The author has given a lot of information about the socio-economic conditions in Uttar Pradesh and the three cities in particular. He has given the maps of the three cities and specified the cluster-formations. Very little space has, however, been given to the description of the actual happenings in Aligarh and Moradabad. We do not see the earlier-stated hypotheses emerging from the description. Another flaw is that the absence of riots in Rampur is stated to be due simply to a 'lack of potency (among the Hindus), in terms of numerical strength, cohesion and leadership', 'for raising conflict with the Muslim majority' (Pp. 103 and 105). This explanation deprives us of any differentials in respect of such factors as may be responsible for people *wanting* to fight. Also particularly missing in the description is any attempt to reply to the charge made by many people that the police in Uttar Pradesh acted in an anti-Muslim way.

The book ends with saying what the police can do to maintain peace. None of the factors like polarisation, cluster-formation, deep-seated animosities and rivalries and the use of all these in political tussles can be influenced by the police. Theirs is a limited job. Even then, as the author says, they can play a positive role by being watchful during the stages of tension-building and rumour-mongering, by trying to defuse the situation, by giving protection to the end, angered by checking criminal elements, etc.

The book, as already stated above, is a limited study. It was probably intended to be a text-book for police training schools. Only those in charge of such training can decide whether the book would be useful to them.

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Allen, Douglas, (Ed.), *Religion and Political Conflict in South Asia: India, Pakistan and Sri Lanka*, Oxford University Press, 1993, Pp. 230, Price: Rs 150/-.

A number of books have appeared in the last two decades on the 'global proliferation of very aggressive religious positions' in politics. This book contains nine articles by nine South Asian Scholars - three each on India, Pakistan and Sri Lanka. Douglas Allen has provided one of these articles as well as an introduction. He says that we cannot explain the current developments by treating either 'essential' religion or 'essential' production - relationships as their sole determinants; neither can we rely solely on an 'anti-essentialist' explanation, i.e., on relying only on historical and social 'contexts'. He therefore commends the approach of the present authors, 'which is difficult to categorise since it is extremely open-ended, diverse and complex' (p. 9).

Five of these articles - one on India, two on Sri Lanka and two on Pakistan - dwell on the core of the religious-political conflict. The other four articles dwell on the position of Muslims and untouchables in India and of women in Pakistan and Sri Lanka.

Gail Omvedt sees religion as 'constituted in reference to ..... social relations of production' so that it serves not only the needs of the ruling class but also as expressions of popular aspirations and popular revolt, i.e., it serves fundamentalist as well as liberationist projects (p. 22). Omvedt has traced both these developments through India's history. She identifies the Bharatiya Janata Party (BJP) with the illiberal forces (though not fundamentalist ones) and, therefore, does not see a bright future for it in spite of its recent successes.

The role of religion in the ethnic conflicts and politics of Pakistan has been examined by Hassan N. Gardezi and Mustapha Kamal Pasha. Gardezi says that the rise of Islamic fundamentalism can be understood only in the context of the material interests of its proponents and the class appeal of their ideological edifice (though there are identities other than 'class'). He identifies the class-structure in Pakistan as follows: three *dominant* classes, namely, the landed aristocracy, the small

indigenous bourgeoisie and the metropolitan bourgeoisie; two *dominated* classes, namely, the urban and the rural wage/salary earners; and two *intermediate* classes, namely, the salariat and the bazaar bourgeoisie, the last group comprising those small and middle-sized entrepreneurs who have access to the large money-flows resulting from expatriates' remittances, western aid and the arms-and-narcotics traffic. Gardezi observes that in a country like Pakistan, where the capitalist mode of production is not exclusive but only dominant, there is no polarization of social classes into two fundamental groups - the proletariat and the bourgeoisie-, none of the economic classes becomes dominant, so that a non-economic class can become an important ally for any one of them. Such a non-economic class in Pakistan is the Ulama which was a privileged class in the days of the Muslim empires but which lost its position during the British rule. It is with the help of this class that the bureaucratic - military alliance ruled Pakistan. During 1977-88, Sharia flourished 'under the shadow of Zia's sword', legitimised Zia's rule and made it possible for him to extend state control into the domain of the private and personal lives of the citizens as well as their public, political, educational, professional and cultural activities (p. 82). The result was the oppression of the weak segments of the society, the poor, the women and the minorities. Ethnic and sub-national conflicts reached their peak during that period. This legacy has continued to haunt the democratic forces trying to raise their heads subsequent to the departure of Zia.

Mustapha Kamal Pasha brings out some more characteristics of the society in Pakistan and of the role of religion in its politics. He wants us to view the ideological struggles in *all* Islamic countries as battles among social classes over real social questions. His theory is that the 'so-called' Islamic resurgence in Pakistan embodies (i) the stress and contradictions of a social order in transition to capitalism as a social-system, (2) the unresolved struggle for hegemony among the different social classes for structuring social life, and (3) the emergence of a nascent civil society with particular social practices. Since the transition to capitalism has not proceeded very far and development has been uneven, individual efforts

to progress and to accumulate wealth have not become a general feature of the society and, therefore, have not received legitimacy. There is thus an attraction for the old order of morality. Since society is fragmented, there is a constant struggle for hegemony. In this struggle, the nascent civil society, like the Ulama, joins up with the state. Islamic ideology, which was propagated by the Muslim elite in undivided India, thus got support in Pakistan from the Ulama, the civil society and the earlier elite which had captured the bureaucracy at the time of Independence. This combination then succeeded in expanding Islamic ideology to such an extent, particularly during President Zia's regime, that the ideological alternatives available to Zia's political successors are very restricted (p. 121).

Pasha recognises some other factors also in the growth of Islamisation. 'We see', says he, 'Islamic ideology as social consciousness, pervading a wider space than class, though it may originate with particular classes or strata' (p. 121); that 'Islam is a shared value system, not simply a class outlook' (p. 123). The discontent against capitalism is also two-fold: its benefits have not reached the masses and those who have benefited from it have lost the moral values cherished by the old, Islamic order. The move towards Islamisation is therefore a move for the protection of some values and also for the preservation of a distinct identity of a people, a nation. This Pasha calls a move for nativization. Pasha recognises that a 'confluence of patriotism and nationalism offers nearly limitless possibilities for illiberal politics' (p. 126), but he also believes that the civil society will eventually become free from the state and will be able to generate 'a variety of ideological forms'. Of course, 'this may be an extended historical process, and in a transitional society such as Pakistan, ... a linear movement (towards such a goal) can(not) be anticipated' (p. 128).

Gananath Obeyesekere, a professor of anthropology, and Douglas Allen, a professor of philosophy have written about the historical existence of a contradiction between the universal compassion taught by Buddhism and the violent expression of a Buddhist - Sinhalese nationalism. Obeyesekere has pointed out how the story of king

Dutthagamani has changed over time. Dutthagamani was a Buddhist king who waged war against and killed the Tamil King Elāra. Dutthagamani's Buddhist beliefs could not justify this killing. Moreover Elāra was known to be a just king. Dutthagamani had therefore a crisis of conscience. This story of the second century B.C. as written down in the Mahavamsa of about the seventh century A.D., says that Dutthagamani, for calming his conscience, built a temple in honour of Elāra and ordained worship there. This story has however been twisted and re-twisted by historians, philosophers, politicians, archaeologists, etc., to suit their own persuasions. The story continues to be evoked even in present times inasmuch as when an archaeologist claimed sometime after 1946 that he had found the ashes of Dutthagamani, those ashes were deposited in a government museum and were taken in 1980 in a motorcade from Colombo to Dutthagamani's birth-place, and thence to Anuradhapura, where he had defeated Elāra. A recent writer refutes the version of the conscience-stricken Dutthagamani and says that the king was simply doing his duty by fighting invaders 'who were wrecking Buddhist institutions and damaging Buddhist monuments' (p. 154). Obeyesekere calls this a new myth-making by scholars to counter the myth of Dutthagamani's conscience. It is lapped up by the masses; but Obeyesekere feels that whatever the truth about the story, justifying the killing of one's enemy is a perversion of Buddhism. He calls upon the academic community to say clearly where they stand on this issue.

Douglas Allen relates this new myth-making to the existence of a popular Buddhism alongside the canonical Buddhism. This popular Buddhism has been there all through history and has been more in line with man's worldly life. The actual existential condition of Sri Lankans had worsened under the western model of an atomistic individualism. So they sought their identity in a community defined by popular Buddhism. That identity was equated with one ethnic community (Sinhalese Buddhists), one religion (Theravada Buddhism), one language (Sinhala) and one race (Aryan Sinhalese). Allen points out that all these equations can be refuted but such refutation will not dispel the living myth existing among the

masses and will not, therefore, resolve the conflict; what is necessary is the creation of new myths by 'contextualising the Buddhist appeals to ideals of love, compassion .... and the transcendence of the ego' (p. 200). Allen says that this is exactly what many scholars are doing today.

We now come to the peripheral issues.

Ashgar Ali Engineer has traced the history of Hindu-Muslim relations in India. He has observed that the Muslims were as eager as the Hindus to throw out the British, that the Ulama advised them to join hands with the Congress, that the Ulama was against the creation of Pakistan, and that the communal conflict was in reality a fight between the elite of the two communities over sharing of power. Engineer is correct in observing that the Indian way of life is less individualistic and more communitarian so that politicians aspiring for power tend to appeal to the communal consciousness of the people. Engineer has detailed the deleterious effect all this had on the Muslim community. What he laments is that 'successive Indian governments have in their eagerness to win or retain political power tampered with (the) secular spirit of the Indian Constitution' (p. 64). He calls for a strengthening of secularism.

Barbara Joshi outlines the position of 'untouchables' in India: violence is still committed against them; they are isolated from all levers of power; organisational and ideological development among them remains thwarted because there is a divisive hierarchy within their own ranks and they are spread out in small groups all over the country. However, their struggle for economic upliftment and regaining human dignity is progressing, thanks to the Independence movement, more mobility and intermixing brought about by economic changes, and to the value of their votes in the democratic process. Barbara Joshi says that the progress in their struggle has 'led many untouchables to a fundamental optimism about the radical potential of democracy and the modern state' (p. 48).

The position of women in Pakistan and Sri Lanka has been discussed by Shahnaz Rouse and Kumari Jayawardena, respectively. Rouse describes the various changes in the location of gender in the Muslim community, following the

economic and socio-political changes brought about by the colonial rule. Firstly, the entire population was enumerated along communal lines which increased communal consciousness and engendered a division on communal lines. An opposition to colonialism also grew and called for the establishment of the identity of each community. While there was a movement for modernity, there was also a movement for Islamisation in the Muslim community. Both movements adopted similar positions towards women. 'In the public realm, membership in colonial institutions was accepted and even encouraged .... Islamic identity was, however, to be maintained in the private realm, that is the family'. Thus 'cultural and national assertion was to be achieved at the cost of women' (p. 91). Men had to be fitted urgently for the changing public realm; women's education had a lower priority and a different purpose: that of maintaining ethnic identity. These contradictions were further compounded by the role of Islamisation in the political struggle among various classes, resulting in more limitations on women under the *petit-bourgeois* military-bureaucratic rule. The author says that Pakistani women themselves have willingly confined themselves to these limits, and that they must reconsider and subsequently reconstitute their gender location and connected struggles.

The present book does not contain an examination of women's position in India; but it is remarkable that Partha Chatterjee has in an article included in *Recasting Women* described the position of Indian women in much the same terms as above [Chatterjee, 1989]. He has also observed that while men adapted themselves to the changing public realm, they expected their women to hold high the banner of India's (Hindu) culture, that Indian women willingly accepted these limits and that the need now was for them to go beyond the dichotomy of inside/outside realms and of material life/culture or of the corresponding masculine/feminine rules and to wage a new struggle for their emancipation.

In Sri Lanka also, gender discourse has, as described by Kumari Jayawardena, the same elements as in India and Pakistan. She notes that everywhere 'the ethnic identity of each group is frequently expressed in terms of its womanhood

and its vision of the ideal woman' (p. 162). She also describes how womanhood in Sri Lanka was controlled by Sinhalese Buddhist nationalism. In Sri Lanka, as in India and Pakistan, the emergent bourgeois was weak and so the national revival attempted by it took an ethnic and religious form. But only the Sinhalese-Buddhist sons of the soil asserted themselves in this form. The daughters of the soil and the minority groups 'were pushed into a space determined by (these sons)' (p. 164). This limited space was, for women, of a few approved roles: an ideal wife upholding the culture of Buddhism; a mother giving birth to heroes for fighting the ethnic wars; well-to-do women doing charity work and, lastly, aged women spreading Buddhism through their personal conduct. Kumari Jayawardena concludes by saying that only a feminist would be able to project a vision of a society that has overcome both ethnic and gender subordination.

On going through these articles, we find a good deal of similarity in the situations obtaining in these three countries. This is natural since these countries have gone through the same historical process. With an incomplete transformation to a capitalistic mode of production, the society remains divided into several segments and classes and there are, naturally, conflicts among them. One dividing line is religion which then becomes a rallying point for each group. The current problem in all the three countries is how to tone down and then eliminate the bitterness created in the past. Omvedt's belief is that the Hindutva in India is the ideology of a minority and that the classes and segments constituting the majority will eventually dominate the scene. Gardezi says nothing about the future. Pasha puts his trust in the ability of the civil society in Pakistan to generate new ideologies by some distant future. Douglas Allen calls upon monks and scholars to mould Buddhist ideology in the context of today so that it can counter hatred violence and assist 'new models of economic and social development and ethical and spiritual liberation' (p. 200). He no doubt includes gender justice in this agenda.

Allen indeed expects a good deal from religion, which is perhaps right since religion continues to be an important part of what Pasha calls the social consciousness of the people of South Asia.

Religion is unlikely to lose that position in the near future because it addresses a question which neither science nor the capitalist mode of production can answer. That question is not just of values, an aspect which Pasha recognises, but of what validates these values. Why should I be fair to my neighbour and not covet his wife or wealth? Rationalist answers don't go very deep. Utilitarian answers are worse. The validation of ethics therefore depends on what is supposed to have been commanded by God or enjoined by such exceptional, almost divine persons who are believed to have acquired knowledge about the essential reality of the universe and the human self. So, religion cannot be given up. As Allen says, it has to be remoulded. That is the justification of the Indian variety of secularism which aims at harmonizing the thoughts of all religions. Once a role for religion is accepted, there is no clear-cut distinction between the so-called secular and the so-called communal forces. The former have to accommodate religious sentiments as the Congress did in accepting the Hindu card. The latter has to accommodate the requirements of today's mode of production, exchange, individual rights and democracy. That is the turmoil going on in India today. Secularism certainly needs to be strengthened as Engineer says, but that would be the secularism of the Indian variety. An active policy in this regard will have to recognise the strength and validity of a party like BJP. Omvedt is wrong when she looks upon the BJP as a starkly illiberal outfit. That it is not. It would not have even survived with an illiberal ideology, much less prospered as it has done in recent years. It tries to be liberal within the Hindu fold as witnessed by the support given by its youth-wing to the Mandal Commission's recommendations for the reservation of jobs and studentships for backward classes. Of course its class-constitution limits its liberality but there are elements within it which can go beyond their class limitations. Now that the party is trying to attract the Muslim vote, the party as a whole will have to be reasonable towards the Muslim community. This is, however, difficult for it to achieve because of its conviction that there is really no common space where Hinduism and Islam can meet. This conviction is buttressed not only by the constant

claim of the Ulama - interpreted Islam of being the only full and final code of conduct, but also by scholars like Arun Shourie who enjoy digging up some sordid realities from Islamic literature. (Recently he has brought out a book on the world of *fatwas*) If, as Allen says, what is necessary is the 'imaginative creation of new narratives' (p. 193), i.e., creation of new myths, then Arun Shourie's scholarly research into 'reality' (which is not a major part of the total reality), is positively harmful to any harmonisation project. It is across such hurdles that Indian secularism is progressing. Any activist, if he is to do a good job, must draw upon the positive elements in all classes and political parties, the BJP and the Ulama included, for the success of a harmonization project. Indian conditions are favourable for such a project. The state and the growing civil society are in its favour, and even those who advocate cultural nationalism are no longer fundamentalists but are accepting modern values. The activists in favour of secularism need only to persevere in their efforts.

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Saxena, N.C. and Vishwa Ballabh, (Eds.), *Farm Forestry in South Asia*, Sage Publications, New Delhi, 1995, Pp. 393, Price Rs 425.

Apart from seasonal and annual crops like rice, wheat and sugarcane, farmers have also been growing trees on their holdings though on a much more limited scale. However, until recently, tree crops on farm lands received little attention from social scientists. Growing of commercial trees like eucalyptus first received a sharply critical attention in the early 1980s based on the experience in Kolar in Karnataka [Shiva *et al.*, 1981]. While this critique was mainly on ecological

grounds, Saxena made a comprehensive economic critique of the whole experiment in North India in a well known book earlier [Saxena, 1994]. Readers who have gone through this book will find many of its echoes in the work presently under review. In fact, several studies by Saxena on the theme appeared even earlier [e.g., Saxena, 1990(a) and 1990(b)].

The scope of the book under review is broader than the above studies, since they take into account experience of other regions too, and of growing other trees too in addition to eucalyptus. It is an outcome of a Workshop held in March 1991 at the Institute of Rural Management, Anand (IRMA). The volume has as many as 14 case studies from different ecological regions of South Asia, covering both traditional farm forestry and the new commercial farm forestry. Apart from India, the volume presents interesting accounts of experience in this regard in Bangladesh, Nepal, Pakistan and Sri Lanka too. In addition to documenting the experience, the volume also contains chapters by the editors which conceptualise the whole experience and present a connected analytical account. To top it all, there is a perceptive Foreword by N.S. Jodha. As such, the volume has enough rich and in-depth material to make it a rewarding reading of abiding interest both to scholars and policy makers.

We can distinguish really between three types of farm forestry. The traditional farm forestry itself is of two types, of which only one is recognised and discussed in this book. The one which is recognised is where farmers grow trees on bunds and on their homesteads for multiple purposes like raising fruit for home consumption, a little usufruct for sale too when it is available in excess of self consumption, and for meeting fodder and fuel needs, again mainly for self consumption. Under this type, several types of trees are grown in a scattered way rather than as a block plantation.

The traditional farm forestry also had a mainly commercial segment in the form of orchards. Unlike in the first type above, these are raised as block plantations. Even if we ignore coconut and arecanut plantations, which are also important tree crops, there are other trees like mango, guava and cashew which may have received some

stimulus of late, but are nevertheless traditional. These hardly receive proper attention in the book, and therefore the problems which these tree growers face are not discussed.

It is mainly the third type of farm forestry - the cultivation of eucalyptus, casuarina and to some extent poplar - which monopolise the attention of the authors in the book. This is understandable since this is a recent phenomenon and involved probably a larger number of farmers than those in the first two types. Moreover, the importance of commercial farm forestry has increased especially in the context of the policy trend to expect farmers to supply the pulpwood that the country needs, instead of raising it in public forests. The book avoids getting bogged into purely ecological controversies. The papers in the book show how farmers were misled into planting with high density, resulting in poor productivity in terms of economically valuable poles, though there may have been a high output of biomass which fetched very low value. There was also far more pulpwood than the market could absorb at expected prices in North India. While as per expert advice, a rotation of 12-14 years would have produced best results for eucalyptus, farmers actually tended to harvest much before eight years. It is not that they had no foresight, but the price situation was gloomy, and did not give scope for optimism. Moreover, subsequent thinning did not improve tree girth, and delaying harvesting could not have brought additional gain.

There is some difference in the experience of eucalyptus cultivation between north India (Punjab, Haryana and Western Uttar Pradesh) and south (Karnataka). It seems that eucalyptus was grown in more fertile areas in the north than in the south, resulting in high opportunity costs for eucalyptus in the north. It is not clear which crops they replaced in the north, but eucalyptus was grown in marginal lands in Karnataka at the expense of low yield and low value crops like ragi. In the circumstances, eucalyptus cultivation was hardly sustainable in the north and was extremely vulnerable to market forces. That is how, 'in the long chain of cropping patterns that the north Indian farmer has tried, eucalyptus remained an aberration, "a five-year wonder" arising in 1981 and dying down by 1986' (p. 273).

If this was the fate of eucalyptus in most of the areas, then what happens to Saxena's own recommendation to get pulpwood mainly from farmers rather than from forests? This question is not properly discussed in the book. Nor is there any attempt at estimating how much land would be available from private holdings to raise pulpwood and whether it would be enough to meet the needs of the industry.

While Indian studies in the book have been more preoccupied with eucalyptus, the imbalance is somewhat corrected by the studies from other South Asian countries which have given more attention to traditional farm forestry. A heartening finding from a case study in Nepal by Gilmour and Nurse is: 'It seems clear that, in the Jhiku Khola catchment, the pendulum swing of deforestation has been arrested and has begun to swing in the other direction - towards a landscape with more, rather than fewer trees' (p. 102). Farmers have been growing a mixed variety of trees which meet their needs, on the upper slopes of their holdings and also on common lands. The shifting cultivation of earlier years has reportedly given way to sedentary cultivation. A comparative study of Sri Lanka, Bangladesh and Nepal by Wickramasinghe also shows that farmers do grow trees for multiple purposes even without a back-up from the State in the form of incentives, subsidies and motivation expected to be prescribed through extension agencies (p. 155).

We cannot, however, generalise that farmers tend to grow more trees everywhere. The case study from Pakistan by Dove has shown that in this regard, farmers are more prone to grow trees in isolated villages than in the more accessible ones. 'The greater the access to and orientation towards urban markets, the greater the likelihood that all available land will be devoted to high income crops' (p. 168).

Pathak's perceptive observation is relevant here - 'Commercialisation and Mechanisation of agriculture in the pockets in which these are confined, have changed the role of trees on private lands even further. Mechanisation of ploughing, irrigation and threshing operations has made people relatively independent of wood and biomass. Trees obstruct the passage of tractors and

it is not possible to plough under a tree, necessitating the removal of trees. The loss of crop due to shade of trees on agricultural land, in the context of high input costs and the possibility of earning from land, offsets the relative advantages of having a tree on farm land. Thus, commercialisation and intensification of agriculture have made it desirable to remove trees from private land' (p. 58).

There is a further discouragement in growing trees on private lands from legal and procedural hassles involved in taking permission for felling, transportation, etc. This point is emphasised particularly by Pathak. 'In fact, taking permission to fell and transport trees standing on private land is itself a mechanism to pilfer forests and transport timber to markets in the guise of timber drawn from private lands' (Pp. 59-60). What is the solution then? Should the Forest Department remove all such procedures and restrictions as is done in the case of a few quick growing commercial species like eucalyptus? Such 'liberalisation' did of course stimulate or at least help their cultivation. But what will be the impact of such liberalisation in the case of slow growing timber trees? Will it or will it not make pilferage of forests easier, even if it may stimulate growing such trees on private lands? Unfortunately, there is no in-depth discussion of this issue in the book.

In spite of a few gaps pointed out above, the book makes a rewarding reading. There are several other points of interest in the book apart

from what is discussed above. For example, there is a good documentation on the structure and functions of wood markets, particularly in two papers by Saxena and Aziz, respectively. Case studies of Gujarat by Sharma, Ballabh and Pandey, and of West Bengal by Katar Singh and Bhattacharjee are also no less interesting than others.

Nowadays, plenty of books are coming in the market on environment and forest issues most of which are superficially written and are hardly readable. It is refreshing, against such a background, to have this book which is eminently readable, quite perceptive and enlightening to interested scholars.

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Shiva, Vandana, H.C. Sharatchandra and J. Bandyopadhyay, 1981; *Social, Economic and Ecological Impact of Social Forestry in Kolar*, Indian Institute of Management, Bangalore (Mimeo).



## ANNOTATED INDEX OF BOOKS AND ARTICLES IN INDIA

### EDITOR'S NOTE

These abstracts are prepared by the author of each book/article sent to us voluntarily in response to our invitation through the Economic and Political Weekly. These cover publications after January 1, 1986. Only abstracts of books/articles so received are published. The index, therefore, is not exhaustive and complete.

The limit of 250 words and 100 words for abstracts of books and articles, respectively, is strictly enforced. Only a minimum amount of copy editing is done in order to bring the abstracts within the prescribed limits. The readers should approach the author of the abstract, not this Journal, for any clarifications.

### ARTICLES

1990

Samal, Kishor C., *Linkages Between Informal and Formal Manufacturing Sector: Case Study of A Steel City (Rourkela)*, (mimeo), Post-Graduate Department of Economics, G.M. College, Sambalpur, Orissa, 1990.

This is a report of the study financed by the Indian Council of Social Science Research (ICSSR), which deals with various types of linkages of modern informal manufacturing sector (IMS) with the formal manufacturing sector (FS), that too in Rourkela- the seat of the first public sector iron and steel plant in India - in the tribal populated Sundargarh district of Orissa. In a broad sense, the relationship through the output of IMS is termed as forward linkages, and via its input as backward linkages.

A great difference between linked and non-linked units is observed in relation to fixed capital and assets, working capital and goods produced. The linked units are comparatively more capital-intensive. Most of the establishments in the linked IMS have linkages with the Rourkela Steel Plant (RSP) and around half of their total sales goes to RSP. The linked IMS have direct linkages with RSP either through (i) selling their outputs to RSP or (ii) purchasing their inputs from RSP. Comparatively bigger formal sector units including RSP and Larson and Toubro have

established linkages with IMS in Rourkela, but most of them purchase spare parts and consumables from the FS units. About three-fourths of the non-RSP FS units have linkages with RSP. They sell goods which are procured from the IMS and processed in their units. Thus, RSP plays an important role in establishing linkages directly and indirectly with IMS units in Rourkela.

1994

Samal, Kishor C. *Dynamics of Informal Manufacturing Sector (A Case Study of Sambalpur at Two Points of Time)*, (mimeographed), Nabakrushna Choudhury Centre for Development Studies, Bhubaneswar, 1994.

This is a report of the research Project funded by the Indian Council of Social Science Research (ICSSR). This is a study on revisiting the sample of informal manufacturing sector (IMS) within 10 year period for the refinement of the concept of IMS and to observe the consistency or inconsistency of their working and characteristics. It is the first of its kind in India on informal sector. The main objective of the study was to verify whether any noticeable difference can be found in the nature of informal manufacturing sector establishments when they are grouped under three headings, viz, (a) micro-business, (b) petty producer, and (c) small capitalist producer.

It is observed by this study that in various respects such as the size of employment, annual

turnover, fixed capital and assets, etc., small capitalist producers are distinctly different from micro-business and petty producers. It is argued that irrespective of the size, the informal manufacturing sector includes (1) micro-business, (2) petty producers, and (3) small capitalist producers who have (a) unprotected wage work, and (b) unprotected economic environment. It is also observed by the study that very small units in informal manufacturing sector such as micro-business and petty producers are unable to get any assistance during the 9-year period (1985-1994), though the average size of employment of these units is increasing. On the other hand, small capitalist producers (comparatively larger units) are able to get various types of assistance, though their average size of employment is declining. Thus, assistance to small scale units in the name of employment generation without bringing any distinction among them is irrelevant. Small scale units use various tactics such as inflating capital cost, change of name at certain interval to be 'new', etc., to get more concessions and subsidies. So, no assistance from public institutional system is desirable to an individual to start a new unit. Rather assistance may be provided to only 'existing and operating' units who are operating on their own but facing various structural difficulties and problems instead of creating a new 'parasite middle class' through political and bureaucratic support. It is pointed out that problem of finance for both working and fixed capital is the major problem of the IMS units. They need credit in adequate amount without delay and red-tapism, but not necessarily at concessional rate of interest. The IMS units are even ready to pay higher than the normal market rate of interest since they procure their requirement at a far higher rate in informal credit market.

For this, the study concludes that there is need for 'institutional radicalization'.

Samal, Kishor C., *Linkages of NALCO Angul Sector with the Manufacturing Sector in Orissa*, (mimeo), Nabakrushna Choudhury Centre for Development Studies, Bhubaneswar, 1994.

This study is conducted for NALCO Chair in Nabakrushna Choudhury Centre for Development Studies (NCDS), Bhubaneswar, to analyse whether the massive investment of a Public Sector Unit like NALCO has helped the growth of industrial units in Orissa in general, and in Angul in particular, through both backward and forward linkages.

It is found that the forward linkages of NALCO Angul sector (consisting of smelter plant and captive power plant) of Orissa are primarily through the sale of aluminium ingots and wire. Around 67 manufacturing units in Orissa purchase aluminium metal directly from NALCO, and about 13 units indirectly from NALCO through OSIC. Mainly, aluminium consuming units, like cable and utensil units, have linkages with NALCO but dependence of cable units is more on NALCO. Around 29 per cent of the total purchase of main inputs and raw materials (in money terms) of the forward-linked manufacturing units is from NALCO Angul Sector. Similarly, 3.72 per cent of the total sales turnover of aluminium metal by NALCO is within Orissa. Thus, it is found that the forward linkages of NALCO Angul sector with Orissa's manufacturing sector are negligible. Power and aluminium are the major inputs of NALCO Angul sector which are available from its captive plants. The backward linkages of NALCO are mainly established through purchase of ancillaries, spares, consumables and miscellaneous items from around 65 units in Orissa which are also insignificant, erratic and irregular.

However, in Orissa, there is scope for setting up of at least five major forward-linked manufacturing units. There is also possibility of setting up

of potential backward-linked industries of NALCO, such as aluminium fluoride, calcined petroleum coke and coal tar pitch in Orissa.

1995

Mallik, R.M. and S.P. Padhi, *Irrigation System in Orissa: Its Impact on Agricultural Development*, Nabakrushna Choudhury Centre for Development Studies, Orissa, Bhubaneswar.

The present study looks at the impact of five types of irrigation system (namely, major/medium/minor, canal; river lift; tank) based on surface water and three types of irrigation system (namely, government tubewell, private tubewell, dugwell) based on ground water. The impact is studied for the following variables, namely,

cropping intensity, cropping pattern, crop yield, farm business income, value added, on-farm employment and extent of tenancy. The impact is also analysed across different size-classes of land holding for each system. The study also touches upon the question of mechanism of water management which, it is argued, can have an important bearing on productive efficiency of any system of irrigation. Broadly speaking, medium canal and dugwell emerge as the most productive types of irrigation system in terms of the magnitude of per cent increase in per acre farm business income and value added, the two most inclusive measures of the impact of irrigation on the farm economy. Finally, the study took a critical look at the problem of water management under different systems of irrigation.

The Journal will publish in each issue Annotated Bibliography of Books and Articles on Indian Economy, Polity and Society, published after January 1, 1986. Authors are requested to send their entries with full details of publication and annotation not exceeding 250 words for books and not exceeding 100 words for articles. Use separate sheet for each entry.

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All quotations should be checked carefully for accuracy, and should be unaltered except for

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All footnotes and references should be at the end, first footnotes, then references. In the text, footnotes should be numbered consecutively by superscripts following the punctuation. Reference citations in the text should be enclosed in square brackets, as follows: [Author, 1965, p. 9]. References listed at the end should be arranged alphabetically by author and should include the following information: for articles - author, year of publication, title, name of journal (underlined), volume and issue number; and for books - author, year of publication, title (underlined), and publisher, in the following format. We convert underlining into italics.

Maital, S., 1973; 'Public Goods and Income Distribution', *Econometrica*, Vol. XLI, May, 1973.

Chakravarty, S. 1987; *Development Planning: The Indian Experience*, Clarendon Press, Oxford, 1987.

If a Reference is cited in a Note, the Note may use the shortened reference form:

4. For a critique of recent industrial policy proposals, see Marshall [Marshall, 1983, Pp. 281-98].

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### MATHEMATICAL AND TABULAR MATERIAL

All tables, graphs, figures, and illustrations should be numbered and amply spaced on separate sheets of paper indicating in a marginal note in the text where such material is to be incorporated. Mathematical equations should be typed on separate lines and numbered consecutively at left margin, using Arabic numerals in parentheses. Use Greek letters only when essential. The word *per cent*, not the symbol %, should be used in the text and the tables.

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