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FEDERAL INDIA - BURNING ISSUES IN UNION-STATE RELATIONS

G. Thimmaiah

The last decade of the 20th century has witnessed both break-up of two federations and an attempt to form a new federation. This has got some lesson for India. India is a quasi-federation. Both political and financial powers are tilted in favour of the Union government. These were used by the Congress party to promote the centralisation process in political, financial and administrative spheres. This led to discontentment among the states and demand for more autonomy. The most contentious issues in regard to the Union-state relations today are: the increasing number of Centrally-sponsored Schemes, declining proportion of financial transfers on the recommendations of both Planning and Financial Commissions, attempt to centralise states' sources of revenue, refusal to revise royalty on minerals, impact of administered prices on state finances, location of Central government units in different states and the distribution of Central assistance for state Plans based on Gadgil formula. However, the states also have got some responsibility in a federation. They include, reducing the revenue and fiscal deficits, controlling non-plan expenditure, pricing of the goods and services supplied by their public enterprises, reforming the tax systems to harmonise with the national tax reforms and devolving adequate funds to the Panchayat Raj Institutions (PRIs) and Urban Local Bodies (ULBs) to enable them to function as grassroots level democratic units. All these require a more dispassionate decision making by the national and state level political leaders.

BACKGROUND

The last decade of the 20th Century has witnessed the most unexpected developments in the sphere of federalism. Paradoxically we have before us a trend which is characterised by movements towards both formation of new federations and disintegration of two federations. The European countries who fought two world wars in order to retain their political identity, are moving towards a unified monetary and political system. They are encouraged by impressive economic benefits of the economic union which was formed after the second World War. The year 1993 witnessed their determination to aim at financial integration, paving the way for European federation. The Maastricht Treaty has been signed and a road map has been prepared for achieving total economic and political integration of the European nations.

The European trend is a miracle viewed against their historical background. Their diverse languages, their ethnic heterogeneity and even their independent political history have not come in the way of the proposal to form a United Europe. Even a proverbially neutral country like Switzerland has joined this movement attracted by a bigger market for its labour force and productive capital. This movement is also motivated by the desire to claim independent political identity in the changed unipolar world scenario where the United States of America (USA) has emerged as the single largest economic and military power. While the earlier fear of Soviet Union is no longer relevant for these European countries, the new fear of domination by the USA in the world economy has compelled small European countries to work towards a federal union. Even so, the anticipated federal union has not yet come into operation. Factors which are delaying formation of a federal union are the ethos of their linguistic and cultural identities, long history of independence, existence and hidden fear of one or two European nations dominating the other members of the union. These inhibiting factors are important pointers to the Indian federation. For, we have been trying to develop a nation out of much more diverse regional identities. The recent demand for separate statehood based on ethnic and cultural identity like Jharkhand gives a clear indication of the need for accepting the cultural diversity and ensuring political autonomy within the federation.

On the other side of the European continent, USSR and Yugoslavia have disintegrated as federations. It is a well known fact that these two federal nations were put together through coercion and were held together by very powerful Union governments. Over-centralisation led to

G. Thimmaiah is Member, Planning Commission, New Delhi.
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absence of regional participation in the governance. Absence of regional participation in the affairs of these countries led to alienation of their people. Centralised allocation of resources created dissatisfaction apart from stagnation of the pace of development resulting in deterioration of the standard of living of the common people. Lack of autonomy for the regions led to the collapse of the two federal systems when the Union authorities became weak. This event has also got a lesson for Indian Union in that the States have been demanding adequate degree of political and financial autonomy for a long time. If the demand for fair degree of autonomy is not conceded by the Union government, the mutual trust between the Union and the state governments will be lost and the whole edifice of the federal structure may shake when the power of the Union government becomes feeble.

INDIAN EXPERIENCE

It is a well known fact that India is a quasi-federation. The constitutional provisions have tilted the balance of power in favour of the Union government. The political and economic circumstances which followed Independence further encouraged centralisation process. The Indian political system started with one party rule until almost the end of the 1960s. This no doubt enforced harmony between the Union and the state governments. But it also developed unjustifiable centralisation process in both, political and financial, spheres. The unquestioned policy of the Union government to direct the state governments' policies even in areas which were constitutionally assigned to them created grumbling dissatisfaction even when there was one party rule. It became more vocal and got an open outlet when different parties started ruling at the state level. The dominating centralisation process of the Union government's political and financial policies have distorted the original intentions of the framers of the Constitution, particularly in the sphere of federal financial set up. This centralising process deserves some elaboration.

Immediately after Independence, the national leaders decided to adopt government sponsored economic planning for achieving rapid development of the country. Though this policy was resented by the private sector, a vast majority of the people of the country welcomed it in the hope that it will usher in an era of prosperity to all sections of the society. But the past 46 years of experience with planning has shown that it has not helped achieving the intended objectives of promoting rapid economic development and social justice in the country to the expected extent. As a result, the number of people in absolute poverty has increased over the years though the proportion is showing some declining tendency. Indian development process has created two Indias - relatively prosperous urban India and poverty ridden rural Bharat.

When it was realised that the Indian Constitution had created powerful Union government within a quasi-federal political system, but a more balanced federal financial structure, the Union government probably thought it necessary to expand the centralising process and exercise control over the state governments in the financial sphere also. The constitutional division of functions and the sources of revenue between the Union and state governments, no doubt, made the Union government financially powerful. But certain constitutional provisions also ensured financial autonomy of the state governments. This financial autonomy came in the way of extending financial control of the Union government over the state governments. Therefore, the Union government devised policies and institutions outside the framework of the Constitution to overcome this hurdle to impose its dominance both in political and also in financial spheres. The political supremacy was the source of superiority impulse felt by the Union government. The Union government adopted such policies which made it powerful even financially at least *de facto,* if not *de jure*. Thus, the superiority impulse of the Union government was let loose by the urge to dominate over the state governments. Any act of domination should, however, have the appearance of legitimacy in the field of federal financial relations. In other words, any domination requires the support of some justifiable excuse in a democracy. The Constitution has built some checks and balances through the financial provisions into the financial system of the country. The Finance Commission is a constitutional body. Once its recommendations are accepted, they become an award, and therefore, they have got to be adhered to. Further, the Finance Commission can probe into the financial position and performance of the Union government also. Though there was resistance to such a decision of the Finance Commission, in the recent past the seventh, eighth, ninth and tenth Finance Commissions did probe into the finances of the Union government. Furthermore, the Finance Commissions may even pull up the Union government for any violation of the constitutional provisions relating to federal financial transfers. In fact, the third, fifth and the seventh Finance Commissions have done it, though other Commissions have mildly advised the Union government to follow the established norms relating to Union-state financial relations. Therefore, the Union government was not sure of exercising its control over financial powers of the states through the instrumentality of the Finance Commission. In order to overcome this difficulty, the Union government started using the Planning Commission outside the framework of Constitution to function as a countervailing force to the independent Finance Commission. The exceptional provision made under Article 282 came in quite handy for the Planning Commission to exercise its powers as other financial provisions cannot be used by any extra-constitutional body. Thus, the legitimacy of the Planning Commission to use Article 282 came to be willy-nilly accepted by all the state governments. This has been made possible partly by its composition (and in the early years by one party rule both at the national and the state levels), and partly by the need to have government sponsored economic development plans to make India economically powerful by eradicating mass poverty. Thus, the institution of Planning Commission became a very attractive design for legitimising the process of financial centralisation in the country. This extra-constitutional institution evolved alternative method of financial relations between the Union and state governments in the name of planning and development. The Planning Commission determined the plan size, objectives, priorities, strategies, programmes, schemes and even their location without actively involving the state governments. Realising the logistic disadvantage of the Union government, the responsibility for the implementation of the plans drawn up by the Planning Commission has been entrusted to the state governments. Because of their constitutional existence, the state governments could not be forced to accept the dictates of the Planning Commission. Therefore, they had to be induced to undertake the task of implementing the plans. A traditional and effective means of inducement in a federation is through the bait of financial assistance. Though constitutionally provided Finance Commission was there, it was found inadequate for determining the financial assistance for the states' plans. Thus, the political leaders of the post-Independent India overlooked the wisdom of the Constituent Assembly on matters relating to the financial transfers through the instrumentality of the Finance Commission. Consequently, the scope of the recommendations of the Finance Commission came to be restricted to non-plan part of the states' financial needs through the terms of reference, and all plan needs were made the domain of the Planning Commission. The Planning Commission being a quasi-political body having the Prime Minister as the Chairman and Finance Minister as member, concentrated economic policy making powers in its own hands. Then an alternative financial relationship under Articles 282 and 293, other than the one which was built into the Constitution under Articles 270, 272, 275 and 280 between the Union and the state governments was devised in the name of the plan assistance to states. In this alternative relationship, financial assistance for the purpose of undertaking plan programmes and projects came to be channelled by the Union government on the recommendations of the Planning Commission. In this plan assistance, loans loomed so much as to establish unequal exchange in the flow of financial resources between the Union and the states.

The Union government has not been satisfied with even this alternative mechanism of financial relationship between the Union and the state governments through the instrumentality of the Planning Commission. It has gone beyond both Finance Commission and even the Planning Commission and started providing direct financial assistance through the individual Union government ministries. Such direct discretionary financial transfers can be made under Article 282. But this constitutional provision is supposed to be used sparingly and only under exceptional circumstances. It was not at all intended for making regular financial transfers and, that too, on such an extensive scale. It may be observed from Table 1 that during the First and Fourth Five Year Plans periods, discretionary financial transfers surpassed both Finance Commission and the Planning Commission transfers, and even during the subsequent plan periods they were quite comparable to Planning Commission transfers.

Table 1. Financial Transfers from Union Government to State Governments under Instrumentalities of Finance Commission, Planning Commission and at the Discretion of Union Ministries

(Rs crore)

Five-Year Plans	Finance Commission Transfers				Planning Commission Transfers		Discretionary Transfers		Total Financial Transfers
	Tax Share	Grants	Total	Percent to Total Financial Transfters	Total	Percent to Total Financial Transfters	Total	Percent to Total Financial Transfters	
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
First Plan (1951-56)	344	103	447	31.24	350	24.46	634	44.30	1,431
Second Plan (1956-61)	668	250	918	32.00	1,058	36.89	892	31.11	2,868
Third Plan (1961-66)	1,196	394	1,590	28.39	2,515	44.91	1,495	26.70	5,600
Fourth Plan (1969-74)	1,252	500	1,782	33.33	1,767	30.05	1,798	36.62	5,347
Fifth Plan (1974-79)	8,275	2,773	11,048	43.01	7,722	30.55	6,683	26.44	25,278
Sixth Plan (1980-85)	21,335	1,711	22,888	41.00	16,099	29.34	16,267	29.65	54,862
Seventh Plan (1985-90)	49,465	9,113	58,578	43.77	38,729	28.94	36,523	27.29#	1,33829#
Eighth Plan (1992-97)	1,32,009	19,215	1,51,224	47.09	94,292	23.35	75,588	23.54	3,21,104

Notes: Finance Commission transfers include tax shares, all grants-in-aid under Article 275 and grants in lieu of tax on railway fare. Planning Commission transfers include plan grants under Article 282 and loans under Article 293 for state sector plans only under *Gadgil formula*.
Discretionary transfers include grants under Article 282 and loans under Article 293 for centrally-sponsored and central sector schemes, plus small savings loans, loans for clearing overdrafts and other *ad hoc* assistance.
Discretionary transfer excludes Ways and Means Advance (Rs 1,649 crore).
Source: *Reserve Bank of India (RBI) Bulletins.*

Thus, it is increasingly becoming evident that the Union government is not happy with the rules of the game provided under the instrumentalities of both the Finance Commission and the Planning Commission. 'Discretion' has become an expression of superiority complex and therefore the financial transfers at the discretion of Union ministries have grown substantially both in number and amount. As a consequence of these unexpected developments, today we have three mechanisms through which Union government makes financial transfers to state governments. The first mechanism is the constitutionally provided Finance Commission. The second is on the advice of the Planning Commission which is an extra-constitutional body created, no doubt, for a genuine purpose. And the third is the political-cum-bureaucratic transfers at the discretion of the Union ministries. The financial assistance provided on the recommendations of the Finance Commission comprises tax revenue shares and conditional and unconditional grants.

No loan assistance is provided under this institutional process, except in the form of loan adjustments or writing-off of past loans. But in the case of financial assistance provided through the second and the third mechanisms, loan assistance predominates.

However, the recent experience with coalition government at the national level has generated even international curiosity and has perplexed the blinkered intellectuals of the country. At long last we have a Union government chosen by the state level political parties and supported by a national party. Though Indian Constitution is characterised as quasi-federal with a tilt in favour of the Union government, the true federal polity has come to operate under the present coalition government. This is the outcome of excessive centralisation of political, administrative and economic powers at the Union in the past and the dissatisfaction of the masses with the national political parties coupled with the readiness of the Indian political leaders to experiment with new form of political governance. It is heartening to note that the present 13-party coalition government has provided confidence not only to the regional political parties but also to the state governments in regard to their own powers and status in the Indian polity. Going purely on the basis of the way the political power was organised based on the Constitutional provisions from 1950, nobody expected such a sudden transition from a centralised political system to a *de facto* federal political system to emerge.

BURNING ISSUES IN THE UNION-STATE RELATIONS

Notwithstanding the changed political situation which has brought about perceptible change in the attitude of the Union government towards the states, there are still certain contentious issues which create conflicts in the Union-state relations. They include political, economic and financial issues. It would be appropriate, therefore, to highlight at least the most important burning issues in the Union-state relations which are coming in the way of harmonious functioning of the Indian federal polity.

If there is any one single provision of the Constitution which has encouraged centralisation process and undermined the federal spirit of the Constitution, it is Article 356. This Article empowers the Union government to advise the President to dismiss any elected government at the state level and even dissolve the elected assembly on the pretext of break-down of the constitutional machinery. This one provision has come to be used more than one hundred times during the past fifty years for trampling people's mandate at the state level, to serve the interest of political parties in power at the national level. Though there were some honourable exceptions when the use of Article 356 was considered necessary, it was misused on more occasions than used for valid reasons. This issue was referred to the Sarkaria Commission (*Report of the Commission on Centre-State Relations,* Chairman: R.S. Sarkaria, generally known as the Sarkaria Commission Report) which, while highlighting the misuse of this provision in the Constitution, expressed the need for the retention of this provision to handle unforeseen situations. Such recommendation of the Sarkaria Commission was brought before the Inter-State Council in 1997 which witnessed divided opinion. While the Dravid Munnetra Kazhagam (DMK) party, which was a victim of this Article 356 for four times, and the Telugu Desam Party, which was also a victim, continued to oppose its retention in the Constitution thereby showing consistency of their view, the West Bengal government led by Communist Party (Marxist) (CPM), which was also a victim of this Article, modified its earlier view and suggested that the provision may be retained with appropriate safeguards to prevent its misuse by the Union government. Thus, the non-Congress party governments were divided on its retention in the Constitution. As a result, it is likely that Article 356 may continue without any safeguards for its use. However, most of the state governments agreed on the principles which were suggested by the Sarkaria Commission for the appointment and removal of the Governor and selection of leader to be Chief Minister for forming the government at the state level. Thus, the recommendation of the Sarkaria Commission in regard to the retention of Article 356, and the role of the Governor have come to be accepted by

Table: 2. Transfer of Financial Resources from Union to States for Selected Years

(Rs crore)

Year	Receipts of the Union Government				Resources Transferred to the States						
	Revenue Receipts Including States' Share in Taxes	Capital Receipts Excld. Repayment of Loans	Budgetary Deficit of Union Government	Total Receipts of Union Government (2+3+4)	Share of States in Union Taxes	Grants from the Union to States & UTs	Loans (Gross) from the Union to States & UTs	Gross Transfers to States (6+7+8)	Repayment of Loans by States & UTs	Net Transfers to States (6 +7+8-10)	(11) as per cent of (5)
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
1970-71	4,097	1,124	285	5,506	755	612	1,028	2,395	658	1,737	31.5
1975-76	9,674	2,662	366	12,702	1,599	1,289	1,296	4,184	746	3,438	27.1
1980-81	16,621	6,309	2,577	25,507	3,792	2,796	3,146	9,734	917	8,817	34.6
1985-86	36,698	17,441	4,937	59,076	7,491	7,067	8,473	23,031	2,739	20,292	34.3 (45.1)
1990-91	71,408	34,542	11,347	117,297	14,535	13,293	14,522	42,350	4,653	37,697	32.1
1994-95	134,536	60,308	5,000	199,844	29,388	21,841	17,281	68,510	5,754	62,756	31.4

Note: Figure in the bracket represents the ratio after adding the loans given to the states for clearing their overdrafts/deficits with the RBI to the total receipts of the Union Government as well as to the gross transfer to the states.
Source: Union Ministry of Finance, Government of India, *Indian Public Finance Statistics,* New Delhi, 1995, p. 73.

31.4 per cent in 1994-95. This issue was referred to the Sarkaria Commission which recommended that it would be better to have different proportions of loan-grant components for different states depending upon their level of development. This recommendation has not been accepted by the Union government as it would involve substantial transfer of grant assistance. In any case, time has come that some of the states like Uttar Pradesh, Bihar, Orissa, Madhya Pradesh and Rajasthan which cannot afford to accept large scale plan assistance in the form of loans be given more plan grants than loans. A new scheme will have to be devised in order to help these backward states.

A further complication has been introduced from 1996-97 in the wake of additional central assistance provided by the United Front government to the states for implementing the *Basic Minimum Needs Programme* and *the Accelerated Irrigation Benefit Scheme.* This additional central assistance is not distributed on the basis of the *Gadgil Formula.* The Chief Ministers' Conference which was held in July 1996 suggested that it should be distributed on the basis of the gap between the existing level of *Basic Minimum Services* prevailing in different states as compared to the national average level. During 1996-97, some *ad hoc* formula was used by truncating the *Gadgil Formula* which resulted in giving more assistance to the states like Kerala where *Basic Minimum Services* are at a much higher level than in states like Andhra Pradesh. Therefore, from 1997-98, an attempt is made to estimate the relative shares of the states in the additional central assistance for *Basic Minimum Services* based on the relative gaps in the minimum services. Further, the assistance meant for *Accelerated Irrigation Benefit* is not distributed on the basis of any formula at all. There is a whole lot of *ad-hocism* and discretion which create misunderstandings. This has also created dissatisfaction and the Chief Ministers' of some states protested against giving arbitrarily more money to some states and less money to other states. Furthermore, as will be shown below, no criterion is used for providing central assistance for centrally-sponsored schemes. Whichever state implements the scheme gets money and whichever state can match the central assistance with its own funds will get more funds. This has enabled the better-off states to receive more central assistance under centrally-sponsored schemes than the poorer states. Whatever equity is attempted to be achieved in the distribution of central assistance for State Plans on the basis of the *Gadgil Formula* has been neutralised by the distribution of central assistance for centrally-sponsored schemes because proportionately more assistance goes to better-off States.

Furthermore, the recent decision of the Union government to provide central assistance for Targeted Public Distribution System (TPDS) under which people below the poverty line will get foodgrains at lower price than the PDS price, has created another problem for the government. Here, the Union government will provide, on an average, approximately Rs 25/- per family per month. It has been decided to distribute this assistance in proportion to the population below the poverty line in different states. But there is dispute about the proportion of people below the poverty line. The Planning Commission estimated much lower figure by adjusting the Central Statistical Organisation (CSO) estimates on consumption with the National Sample Survey (NSS) consumer expenditure data. But the Lakdawala Committee which was asked to look into this problem revised it upwards. Recently the Planning Commission has accepted in principle the estimates made by the Lakdawala Committee but has made a minor modification. This will affect different States differently because of change in the proportion of people below the poverty line. In other words, in a vast and diverse country like India where statistical data base is still weak, it becomes very difficult to be objective while distributing the central assistance to the states for implementing various development and welfare programmes. An element of discretion is bound to be there. In such cases Planning Commission and the Union Ministry of Finance have tried to compensate the losing states through other means. This has kept the states satisfied. But such *ad-hocism* should not become a rule because in the past political alignment was used for making such *ad hoc* loans to undeserving states or denying them to some deserving states. Therefore, it is necessary for the Planning Commission to come up with more reliable estimates of poverty. It is also necessary to revise the criteria used in the *Gadgil Formula* whieh deny 20 per cent of the share to the states whose per capita income is above the national average per capita income. Knowing as we do, the degree of error involved in estimation of GDP and State Domestic Product (SDP) in the country, it would be unfair to deny any state a share in as much as 20 per cent of the central assistance among non-Special Category States. Similarly, it is time the Planning Commission revised the loan-grant component of the *Gadgil Formula* assistance. Definitely Bihar, Uttar Pradesh, Orissa, Madhya Pradesh and Rajasthan should get central assistance more in the form of grants than in the form of loans as their capacity to service the loan is limited. The Sarkaria Commission recommended for using two to three varying loan-grant proportions. But the Planning Commission has not been able to introduce change in the existing loan-grant proportion. Since any change affects the states differently, it is very difficult to arrive at a consensus. The philosophy of co-operative federalism might help resolve this issue.

In the field of expenditure functions like agriculture, animal husbandry, health, and social welfare come under State List. But the Union government has not only created ministries but also started dictating the policies to the state governments in these spheres in the name of achieving national standard, promoting modernisation, etc., so much so that the state governments have lost their initiative as a result of the Union government's day-to-day interference in these spheres. While some of the pilot projects are found to be necessary, they have been used only as an excuse for introduction of continuing schemes and programmes. Though Public Interest Litigation has come to be excessively used in this country, surprisingly nobody has tested in courts whether the Union government can incur so much of expenditure and give so many directions to the state governments on the subjects which are exclusively reserved for the states.

The centrally-sponsored schemes have remained a source of friction between the Union and the state governments. Under the Five Year Plan regime, the Union government decided to introduce pilot projects first and then development programmes and schemes in areas of national importance like education, health, agriculture, etc., to create the interest of the state governments in some common goals. But over time they have increased to such proportion as might kill the initiative of the state governments. Today we have centrally-sponsored schemes under virtually every Union ministry. The number of centrally-sponsored schemes increased from 90 at the beginning of the Fourth Five Year Plan to 146 at the end of the Fifth Plan. Today, they are as many as 182. The details about the number and the Ministries/Departments and the amount of central assistance provided are presented in Table 3. It may be observed that most of the schemes fall under the subjects which fall under the State List and hence were within the states' domain. The state governments have always felt

Table: 3 Ministry/Department-wise Expenditure (1992-96) and Outlay (1996-97) on Centrally Sponsored Schemes

(Rs crore)

Sl. No.	Ministry/Department	No. of Schemes	Anticipated Expenditure 1992-96	Proposed Outlay 1996-97
(1)	(2)	(3)	(4)	(5)
1.	Agriculture & Cooperation	44	2,277.07	830.65
2.	Animal Husbandry & Dairying	16	174.57	75.19
3.	Women & Child Development	5	2,022.58	682.40
4.	Education	17	2,774.42	2,219.97
5.	Industrial Development	2	297.77	98.99
6.	Youth Affairs and Sports	5	90.30	23.90
7.	Environment and Forests	21	701.50	263.22
8.	Rural Areas & Employment	10	19,581.83	6,437.00
9.	Rural Development	8	3,749.65	2,149.05
10.	Urban Development, Urban Affairs & Employment	9	998.30	405.00
11.	Surface Transport	2	18.83	12.75
12.	Welfare	16	955.52	330.80
13.	Power	1	35.99	5.50
14.	Planning	1	1.97	1.00
15.	Health & ISM & H	10	1,225.78	509.00
16.	Family Welfare	1	6,211.02	1,535.00
17.	Civil Supplies	2	50.95	30.00
18.	Water Resources	3	551.95	171.92
19.	Labour	2	88.80	55.05
20.	Non-Conventional Energy Sources	6	426.28	171.80
21.	Commerce	1	73.26	30.00
		182	42,308.34	16,038.19

Note: ISM & H - Indian System of Medicine and Homeopathy.
Source: Government of India, Planning Commission, New Delhi, 1996.

that their sponsorship should have been left to the states and the allocation of funds for them should have been made according to the states' priorities. The initiative has been taken out of the hands of the state governments in regard to identifying and designing the scheme, and prescribing the guidelines by asking the state governments only to implement them at the state level. These centrally-sponsored schemes carry varying proportions of central assistance both in grants and loans. However, loan assistance predominates. Once the state governments accept them, they have to find resources for matching the central fund. This results in diversion of states' own funds from their own important priority projects. Wherever central assistance is provided in the form of loans it results in additional burden of debt servicing. It has been found by the Planning Commission that financially better-off states have utilised more central funds under centrally-sponsored schemes thereby distorting the equity principle built into the distribution of central assistance to the states under the *Gadgil Formula.* Many a time these centrally-sponsored schemes compel the state governments to appoint additional personnel. But after the project came to an end the state governments were left high and dry and they had to pay salary for these employees without work. Redeployment of such surplus staff was not allowed till recently. All these factors forced the state governments to demand for transferring the centrally-sponsored schemes to the states. The Union government did respond to this demand positively. But here again, such transfer has taken place only when non-Congress government was in power at the national level. When the Janata Party was in power in 1979-80, the Union government agreed to transfer 71 centrally-sponsored schemes involving Rs 2,000 crore to the states. But subsequently the number has gone on increasing. Today, the number stands at 182 and the amount of central assistance for the centrally-sponsored schemes amounts to Rs 16,038.19 crore in 1996-97. Thus, it may be observed that the centrally-sponsored schemes have not only resulted in centralising process of plan formulation and implementation, but also the justification for having Union ministries under the states' subject. Recently, this issue was discussed at the July 1996 meeting of the Chief Ministers' Conference and it was decided to transfer long operating centrally-sponsored schemes along with the funds to the states. But the Union ministries are still resisting.

Another area of friction is the revision of royalty for the minerals located in the states. Under the Constitution, mineral deposits are the national asset but the states are entitled for reasonable amount of royalty. The Union government has passed legislation controlling the royalty payment under which they have to be revised once in three years. But they tend to remain unrevised for a long period of time making the state governments lose revenue from mineral royalty. Even when they are revised they are done in small amounts and as a result the states do not benefit much. This matter was also presented before the Sarkaria Commission which recommended that royalty should be revised once in two years. Till today it has not been done. On the contrary, there have been attempts to convert *ad valorem* rates on royalty, which are more elastic, into specific rates of royalty which are not so elastic. Further, the Union government has gone on increasing the excise duty on the minerals and kept the royalty rates constant for long stretch of time. Classic example is the royalty on coal and oil which has adversely affected the revenues of Bihar and Assam, respectively. It so happens that economically backward states have got more minerals and the Union government and its agencies (now the private sector) go and exploit them for their benefit without passing on adequate benefit to the poor, the tribals and the state governments. Poorer states like Assam and Bihar believe that by denying higher amounts of royalty for their minerals, the Union government is preventing them from undertaking larger plan outlay for improving the economic conditions of their people. The people in these states tend to believe that this is the major reason for the inability of their state governments to spend more funds on welfare activities. The Union government is getting the blame for not so significant an issue.

STRUCTURAL REFORMS

The state governments have not been able to implement the necessary structural reforms in tandem with the Union government. This is mainly because of the fear of the unknown. For example, there is a demand for introduction of VAT at the state level in place of states' sales tax to reduce its cascading effect on prices. The Union government appointed a Committee and persuaded the state governments to implement its recommendations. But the state governments do not trust the Union governments' intentions in regard to the financial sphere. They always suspect a hidden hand of the Union government to centralise the sources of revenue or take-over some functions and, as a result, there is a natural tendency to resist. Because of this distrust based on past experience, even the well intentioned policies intended for promoting structural reforms are not accepted and implemented by the state governments. This has resulted in fiscal indiscipline at the state level. For example, electricity, public transport and irrigation water are under-priced at the state level. Attempts to revise them have not been successful, partly because of the Union government's own political populism. The states' sales tax systems riddle with inefficiency. They ought to have been replaced by modern VAT system. Some partial attempts were made by Andhra Pradesh, Tamil Nadu and Maharashtra. But such partial VAT failed. Consequently, tax reforms are not proceeding at the state level at the required speed.

Even so, since the United Front government has implemented the *Alternative Devolution Scheme* recommended by the Tenth Finance Commission, it will meet many demands of the state governments in regard to the financial transfers to meet their non-plan requirements. The resultant happy mood of the state governments should be exploited for persuading them to embark upon a comprehensive programme of fiscal consolidation at the state level. For this purpose, it would be better to use the Eleventh Finance Commission which is going to be appointed soon. In view of the fact that the *Alternative Devolution Scheme* which is going to be implemented from April 1, 1997 will reduce the scope of work of the Eleventh Finance Commission, it should be asked to take upon the responsibility of recommending a scheme of fiscal consolidation at the state level. First, the Eleventh Finance Commission should formulate its recommendations on disinvestment programme of state governments' public enterprises and consolidate those enterprises which the state governments would like to retain. Second, the Commission should make a detailed review of the finances of State Electricity Boards, the State Road Transport Corporations and Multipurpose Irrigation Projects, and recommend appropriate pricing of their outputs. This is absolutely necessary to promote efficient operation of these infrastructures in the country. Third, the Commission should formulate a more comprehensive policy of determining the central assistance for state governments affected by natural calamities. In view of the fact that the state governments will receive more funds under the *Alternative Devolution Scheme,* central assistance for *drought relief* should be terminated. Only the expenditure on *natural calamities* relief should be assisted. Fourth, the Commission should review the debt position of all the state governments and make appropriate recommendations to reduce the debt servicing burden of the state governments. Fifth, the Commission should realistically assess the likely growth of non-plan expenditure on maintenance of capital assets created under various plans and recommend earmarked grants for maintaining them. Finally, the Commission should suggest a scheme of replacing the existing sales tax system by a Value-added Tax within a period of two to three years and consequential adjustments in the tax structure of the state governments. These recommendations are absolutely necessary to harness the benefits of liberalisation and structural reforms introduced at the national level.

There are some economic issues which have also contributed to the disharmony in the centre-state relations. They include the impact of frequent revision of administered prices by the Union government and revision of pay scales and dearness allowances of the Union government employees on the state governments non-plan expenditure. Maintaining price stability is the function of the Union government. But whenever prices go up because of the inappropriate policies followed by the Union government, the Union government asks the state governments to maintain price stability. This has become a sort of paradox. No doubt, state governments also contribute to inflation through reckless spending, by incurring budget deficit and by revision of administered prices, particularly relating to the agricultural inputs and produce. Even though the Union government fixes the prices of agricultural inputs and announces procurement prices of agricultural commodities, the state governments go on adding their own mark-up. Besides, in sugar cane growing areas even after the Union government fixes sugar cane price, the state governments on their own add their own mark-up to win the support of the farmers. Consequently, the sugar factories have not been able to make payment to the farmers. There is need for co-ordination between the policies of the Union government and the state governments in these areas to maintain price stability.

Another issue relates to competitive populism of the state governments which has also spread to the national level. The state governments go on announcing target group oriented benefits even though they do not have adequate funds to complete many on-going development projects. What is more, they also indulge in competitive tax rate war in order to attract industries. Such policies ultimately prove to be counter-productive. There is a mistaken belief that industries tend to be located on the basis of tax concessions. It is a well known fact that good infrastructure, peaceful industrial climate and efficient government are important for industries rather than small tax concessions.

Yet another issue is the location of Union government projects in different states and allocation of bank funds mobilised by nationalised commercial banks in different States. While the banks and other development financial institutions are supposed to provide investment and working capital funds to the entrepreneurs based on their financial and economic viability, the state governments think that it is their right to ask for a share in these funds, even though there is no entrepreneurial activity in some states. The case in point is Kerala where the industrial climate is very poor and hence financial institutions do not lend much money. But this is attributed to the failure of the Union government to get them a fair share in the funds mobilised in the State. The same is true of the location of Union government industries. However, now that the Union government has stopped investing in industrial projects, this issue has lost its relevance. But the proportion of bank advances and institutional funds flowing into different states remains a contentious issue between the Union and the state governments. It will be very difficult to compel the commercial banks to lend loans for the economic activities which do not yield adequate returns. They cannot be forced to lend to sectors where recovery of past loans has been very poor. This cannot be questioned by the Union government and the Reserve Bank of India (RBI). All these sectors/sections should re-establish their creditworthiness and obtain bank credit.

Fiscal Deficits of the States

The objective of reducing fiscal deficit has become very prominent after economic liberalisation programme was introduced in 1991. The main reasons for aiming at reduction of fiscal deficits of the Union as well as the state governments are that fiscal deficits have contributed to expansion of money supply and, through that, to rise in prices, and also that fiscal deficits 'crowded out' the private sector from having access to adequate investment funds for achieving higher growth rate of industrial output. Therefore, it was decided that the country should aim at reduction of fiscal deficit. The Government of India implemented it but in a distorted way. Instead of reducing the non-plan expenditure and raising non-loan revenue receipts, it reduced the budgetary support to power sector, railways and agriculture. The argument was that the private sector investment will flow into power sector and agriculture. This did not materialise. Therefore, the power generation capacity could not be enhanced during the Eighth Plan period. Agriculture continued to suffer from inadequate capital formation, particularly in areas like irrigation. No doubt, fertiliser subsidies were reduced which resulted in reduction in the use of fertilisers and consequently fall in the agricultural production during some years, notably in 1995-96. It is surprising that the Government of India has been trying to reduce fiscal deficit only by reducing expenditure side of the budget. It has not been making required efforts to increase the revenue by increasing the ratio of tax to GDP probably because it wanted to give tax incentives to the private corporate sector by reducing the tax rates. Whatever measures which were introduced have, no doubt, reduced the fiscal deficit of the Union government from 8.33 per cent in 1990-91 to 4.5 per cent in 1997-98. It is important to note that the revenue deficit constitutes 30 per cent of the fiscal deficit and the monetised deficit also constitutes another 30 per cent. The remaining 40 per cent forms the capital account deficit. The Government of India has no doubt entered into an agreement with the RBI to control the monetised deficit. But the revenue deficit is still continuing to grow - thanks to the Fifth Pay Commission recommendations and fall in the buoyancy in the tax yield.

The Union government has also started reducing the flow of financial resources to the state governments on the recommendations of both Finance and Planning Commissions with a view to reducing the fiscal deficit. In fact, during the Eighth Five Year Plan period though in absolute terms the federal financial transfers have increased, net financial transfers from the Union government as proportion of the total revenues of the Union Government have declined from 30.1 per cent in 1992-93 to 26.2 per cent in 1996-97. In 1997-98, they have come down further to 23.1 per cent. This is evident from the data presented in Table 7. The state governments feel that they are punished for the sins of the Union government. As a matter of fact, the TFC was asked to formulate its recommendations with a view to reducing the fiscal deficits of the states. The TFC did try to accomplish this. But the state governments are very vigilant and now they are demanding increase in the share of the revenues of the Union government over and above 29 per cent recommended by the TFC under *Alternative Scheme of Devolution.*

The state governments' fiscal deficit is equivalent to the net capital receipts of the state governments, namely market borrowings, central loans, including loans against small savings, provident fund receipts and institutional loans. The Government of India has already reduced the quantum of market borrowings with a view to reducing the fiscal deficit. This has been evident from the sharp reduction of the Statutory Liquidity Ratio (SLR) from 38.5 per cent to 25 per cent. The main objective of reducing the market borrowings is to make available more funds for the use of private sector. It should be noted that there is a fundamental difference between the fiscal deficit of the Union government and that of the state governments. In the case of the Union government, fiscal deficit also includes monetised deficit, i.e., the net borrowings from the Reserve Bank of India. But at the state level monetised deficit is limited to the *ways and means advances* and *overdrafts* when permitted. Moreover, since the limits for *ways and means advances* have been fixed for some duration of time, no increase in the monetised deficit takes place on this account. Hence, for all practical purposes monetised deficit is only incurred by the Union government. At the state level, the state governments do have revenue deficits and overall budget deficits. In the absence of monetised deficit, the only relevant part of the states' fiscal deficits is the public debt of the state governments. However, the responsibility of reducing the fiscal deficit through market borrowings and central loans lies with the Union Ministry of Finance and the Planning Commission. But they cannot reduce them sharply and arbitrarily without taking into account the developmental needs of the state governments. Even so, the state governments should be able to reduce their capital deficits by reviewing the performance of the state government public undertakings so that the budgetary support provided to the loss making public sector undertakings would come down which would, in turn, reduce market borrowings of the state governments. There should not be any budgetary support to the commercial undertakings of the state governments. The state governments' revenue deficits should also be reduced by tapping the available sources of revenue, by appropriately pricing the public services, particularly irrigation water, electricity supply to agriculture, road transport service, urban water supply, etc. More importantly, the state governments should be able to control their non-plan expenditure and also not so productive part of their plan expenditure by not announcing populist programmes.

The state governments' fiscal deficit today is about 3.5 per cent of the GDP (Table 4). If we add both the Union and the state governments fiscal deficits, it will come to 7.5 per cent, (Table 6) which is a danger signal to inflation and private sector capital formation. Therefore, it is necessary for the state governments also to make a beginning in reducing their fiscal deficits by first reducing their revenue deficits. They should not revert back to the same old demand for increased share in the Union government's revenues for reducing their revenue deficits. That is now fixed for five years under the *Alternative Devolution Scheme* of the TFC. They should tap their sources of revenue to the hilt, probably by switching over

Table 4. Measures of Deficit of State Governments

(As per cent of GDP at current prices)

Year	Fiscal Deficit		Primary Deficit		Monetised Deficit*	Conventional Deficit	Revenue Deficit
	Gross	Net	Gross	Net			
(1)	(2)	(3	(4)	(5)	(6)	(7)	(8)
Average for 1985-90	3.1	2.2	1.7	1.6	+0.1	+0.1	0.3
Annual							
1990-91	3.5	2.7	1.9	1.5	0.1	-	1.0
1991-92	3.1	2.6	1.3	1.6	+0.1	-	0.9
1992-93	3.0	2.2	1.1	0.9	-	+0.3	0.7
1993-94	2.5	2.0	0.6	0.6	0.1	0.1	0.5
1994-95	2.9	2.5	0.9	1.0	-	+0.5	0.6
1995-96@	2.9	2.4	0.9	0.9	-	+0.2	0.7
1996-97 (RE)@	3.3	2.8	1.2	1.3	-	0.3	1.2
1997-98 (BE)@	2.9	2.4	0.8	0.6	-	-	0.9

Notes: RE = Revised Estimates BE = Budget Estimates - Negligible
@ Provisional data relate to the budgets of 26 state governments including National Capital Territory of Delhi.
* Data pertain to 23 state governments having accounts with the Reserve Bank of India.
+ Indicates Surplus
The monetised deficit of state governments refers to loans given to them by the RBI net of their deposits with the RBI.
Source: Reserve Bank of India, *Annual Report, 1996-97,* Bombay, 1997, p. 190.

Table 5. Select Budgetary Variables of State Governments

(Per cent)

Item	1997-98 (BE)$	1996-97 (RE)$	1995-96 $	1990-95	1985-90 (Average)
(1)	(2)	(3)	(4)	(5)	(6)
1. GFD/GFD Expenditure	19.49	21.0	18.7	14.9	19.6
2. Revenue Deficit/Revenue Expenditure	6.7	9.0	5.7	5.6	1.9
3. Conventional Deficit/ Aggregate Disbursements	+0.1	2.0	+1.5	+0.7	+0.6
4. Revenue Deficit/GFD	29.6	27.3	26.1	24.8	7.7
5. Non-Dev.Exp./ Revenue Receipts	44.4	41.4	41.3	35.4	29.8
6. Interest Payments/ Revenue Receipts	17.7	16.9	16.0	14.4	11.0
7. States Tax Revenue/ GDP	5.8	5.7	5.8	5.7	5.7
8. States Non Tax Revenue/ GDP	1.6	1.9	2.1	2.0	2.0

Notes: RE = Revised Estimates BE = Budget Estimates
$ Provisional data relate to 26 state governments including the National Capital Territory of Delhi.
GFD = Gross Fiscal Deficit Non-Dev. Exp. = Non-Developmental Expenditure
+ Indicates Surplus
Source: Reserve Bank of India, *Annual Report, 1996-97,* Bombay, 1997, p. 190.

to VAT and by bringing agricultural income from commercial crops under taxation. They should control non-plan expenditure so as not to have any revenue deficit. It is in this way that the structural reforms should be implemented at the state level. This is necessary to make Indian federation a stable one.

Finally, the 73rd and 74th Amendments to the Constitution providing constitutional status to the Panchayati Raj Institutions (PRIs) and Urban Local Bodies (ULBs) have added another dimension to the Union-state relations in general and Union-state financial relations in particular. Till now, the state governments used to criticise

Table 6. Measures of Deficit of The Union Government

(As per cent of GDP at current prices)

Year	Fiscal Deficit		Primary Deficit		Monetised Deficit $	Conventional Deficit	Revenue Deficit
	Gross	Net	Gross	Net			
(1)	(2)	(3	(4)	(5)	(6)	(7)	(8)
Averages							
1985-90	8.21	5.39	4.83	3.80	2.28	2.07	
1991-96	6.11	4.41	1.63	1.67	0.71	1.04	
Annual							
1990-91	8.33	5.73	4.32	3.35	2.75	2.12	3.47
1991-92	5.89	3.99	1.58	1.45	0.89	1.11	2.64
1992-93	5.69	4.28	1.29	1.65	0.60	1.74	2.63
1993-94	7.44	5.68	2.90	3.00	0.03	1.35	4.04
1994-95	6.05	4.23	1.43	1.26	0.22	0.10	3.25
1995-96	5.48	3.86	0.93	0.98	1.81	0.89	2.71
1996-97 (RE)	5.00	3.35	0.37	0.45	0.15	0.55	2.23
1997-98 (BE)	4.50#	3.03@	-0.18@	0.01@	1.10@	**	2.08@

Notes : RE = Revised Estimates BE = Budget Estimates

$ As per RBI records after closure of Government accounts.

** With the discontinuance of the *ad hoc* Treasury Bills, and tap 91-day Treasury Bills, the concept of conventional budget deficit has become redundant.

As per the Budget Speech of the Union Finance Minister 1997-98.

@ Worked out on the basis of the implicit nominal GDP underlying the Budget Estimates of fiscal Deficit/ GDP ratio of 4.5 per cent for 1997-98.

The conventional deficit is the difference between all receipts and expenditures (both revenue and capital) excluding the 91-day Treasury Bill and cash balances. The revenue deficit denotes the difference between revenue receipts and revenue expenditures. The monetised deficit is the increase in the net RBI credit to the Union Government, which is the sum of increase in the RBI's holdings of: (i) Government dated securities, (ii) 91-day Treasury Bills, and (iii) rupee coins adjusted for changes in cash balances with the RBI. The gross fiscal deficit is the excess of total expenditure including loans net of recovery over revenue receipts (including external grants) and non-debt capital receipts. The net fiscal deficit is the difference between gross fiscal deficit and net lending. The gross primary deficit is the difference between the gross fiscal deficit and interest payments. The net primary deficit denotes net fiscal deficit minus net interest payments.

Source: Reserve Bank of India, *Annual Report, 1996-97,* Bombay, 1997, p. 186.

the Union government for encouraging centralisation process in decision making. They also used to grumble about the inadequate financial transfers and always demanded more and more. With the PRIs and ULBs coming into existence, the state governments will also be under pressure from below for giving more administrative autonomy to the local bodies and more funds for performing their assigned functions. In a way, the 73rd and 74th Amendments have taken away some part of the political pressure on the Union government by creating these local institutions. The state governments will be under great pressure to satisfy the PRIs and ULBs which are going to ultimately determine the political fate of many members of Legislatures and of Parliament.

The TFC made *ad hoc* assessment of the financial needs of the PRIs and ULBs and recommended the grants for development purposes. They are routed through the Planning Commission. Several state governments have appointed the State Finance Commissions (SFCs) to make recommendations on the devolution of funds from the state governments to the PRIs and ULBs. Some state governments have, by and large, implemented their recommendations. However, some state governments are reluctant to implement the recommendations. The most disturbing feature is that some state governments have not held elections to the PRIs and ULBs and have not appointed SFCs while some other states have not taken any decision on the recommendations of the SFCs. These require the intervention of the Union government. The Union Minister for Rural Areas and Employment convened several meetings of the State Panchayati Raj Ministers and advised them to expedite their decisions relating to the holding of elections, appointment of SFCs, implementing their recommendations and constitution of District Planning Committees. Even then the state governments have not acted on the advice. Therefore, more serious Union government intervention is called for in forcing the state governments to implement the 73rd and 74th Amendments to the Constitution both in letter and spirit. This will invariably invite criticism from the state governments. In other words, 73rd and 74th Amendments to the Constitution have added one more dimension to the Union-state relations, including financial relations. It will take some time for the states to accept the PRIs and ULBs as necessary part of Indian federal structure. The state governments' attitude towards the PRIs and ULBs will also determine their relation with the Union government.

Table 7. Transfer of Resources from the Union to States

(Rs crore)

	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97 (RE)	1997-98 (BE)
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
A Total Receipts of the Union (1+2+3)	121,850	130,899	153,188	184,618	197,766	230,505	272,430
1. Gross Tax Revenue	67,361	74,637	75,744	92,294	111,237	132,319	153,647
2. Non-tax Revenue	15,961	20,084	22,004	23,629	28,191	33,571	39,750
3. Capital Receipts	38,528	36,178	55,440	68,695	58,338	64,615	79,033
B Transfer of Resources from the Union to States	44,786	50,510	56,953	62,966	69,553	81,123	87,351
1. States' Share in Union Taxes	17,197	20,522	22,242	24,840	29,298	35,107	40,254
2. Non-plan Grants	2,600	2,652	2,318	2,238	5,878	6,129	4,871
3. Non-plan Loans	5,465	4,852	4,921	9,371	9,873	10,066	10,516
4. Plan Support (Grants & Loans)	13,650	15,508	19,395	19,446	17,536	22,407	24,348
5. CSS	5,874	6,976	8,077	7,071	6,968	7,413	7,362
C Gross Transfers to States as per cent of Union's Total Receipts	36.8	38.6	37.2	34.1	35.2	35.2	32.1
D Resources from States to Union	9,990	11,091	13,753	15,676	18,414	20,669	24,334
1. Loan Repayment	3,149	3,366	4,058	4,333	5,325	5,624	6,642
2. Interest Payment	6,841	7,725	9,695	11,343	13,089	15,045	17,692
E Net Transfers from Union (B-D)	34,796	39,419	43,200	47,290	51,139	60,454	63,017
F Net Transfers from Union as per cent of its Total Receipts	28.6	30.1	28.2	25.6	25.9	26.2	23.1

Note: CSS means Centrally Sponsored Schemes.
Source: Computed from Budget Documents.

AN UNEQUAL TREATY
World Trading Order After GATT

Muchkund Dubey

The principal outcome of the Uruguay Round of Trade Negotiations was the Treaty establishing the World Trade Organisation (WTO). This Treaty incorporates agreements and understandings which provide for new rules of the game in international trade, also in new areas such as services, TRIPS and TRIMs which had remained outside the purview of GATT. The treaty also restricts the choices of developing countries in the world trading order and severely limits the flexibility they used to enjoy in the traditional GATT regime.*

Here, the motivating forces behind the launching of the Uruguay Round of trade negotiations and the economic and political factors which shaped the agenda and determined the course of these negotiations, have been assessed from the perspective of the developing countries, particularly India. The institutional implications of the WTO have been brought out. An attempt has been made to suggest how the developing countries can best cope with the challenge of the new world trading order and to use to their advantage the flexibility provided in the texts of the agreements included in the Final Act. In the concluding chapter, the critical choices to be made by India have been elucidated and strategies for future negotiations have been outlined.

I. BACKGROUND

The international trade during the inter-War and the Second World War period was characterised by trade strifes, various kinds of discriminations and trade restrictions erected under high protectionist walls. As a part of the immediate post-War effort to reconstruct the international system, an attempt was made to restore order to international trade, through the provisions of the Havana Charter which was adopted at the conclusion of the Conference on Trade and Employment held in Havana in 1948 under the aegis of the United Nations. The Havana Charter provided for the establishment of an International Trade Organisation (ITO) as a specialised agency of the United Nations. But the ITO proved abortive as the US Congress could not bring itself round to ratifying the Havana Charter. However, the General Agreement on Tariffs and Trade (GATT), which had been concluded during the course of the negotiations on the Havana Charter and which had been envisaged as a part of the ITO, came into effect in 1948.

The post-War international trade has, by and large, been governed by the rules and regulations of GATT. Among the most important purposes of GATT were the removal of discriminatory practices in trade and the progressive liberalisation of trade through the reduction or elimination of tariff and non-tariff barriers. The first purpose was sought to be served by the incorporation of Article 1 of GATT, the most-favoured-nation (MFN), and the second, by the provision in Article XXVIII of GATT, for periodical rounds of trade negotiations for the removal of trade barriers. Eight rounds of trade negotiations have so far been held under GATT, the last one being the Uruguay Round.

The idea of a new round of trade negotiations under GATT after the conclusion of the Tokyo Round in 1979, was mooted by developed countries, particularly the United States, in the early 1980s. This initiative was taken when the economies of major developed countries were still reeling under the severe recession of 1980 and 1981. A low rate of growth was not sufficient to maintain the accustomed increases in the already high standards of living nor the social security system in these countries nor to enable them to make the long-postponed massive investments in their infrastructure. What was at

Muchkund Dubey is Professor in the School of International Studies of the Jawaharlal Nehru University. He is also the President of the Council for Social Development, New Delhi and the Chairman of the Asian Development Research Institute, Patna.

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* Glossary of Abbreviations is given at the end.

stake for the United States and some of its close allies was their way of life and their continuing hold on the world power structure.

Due to the compulsion to continue the arms race, unwillingness to bring about any change in the pattern of profligate consumption, rigidity of wage structures, the power of domestic lobbies, etc., these countries, particularly the United States, were not in a position to carry out the structural changes in their economies which could have put them on a path of higher rates of growth. They, therefore, decided to resort to an external means as a substitute for domestic structural adjustment. If Super and Special 301 provisions of the US Trade and Competitiveness Act 1988 constituted a crow bar to pry open the markets of developing countries, the new round of trade negotiations was designed to dismantle all the defences of these countries against the unrestricted entry of the US goods and services in their markets.

In the early 1980s, there was also a perception in the United States that while it had become less competitive in the world trade in goods, it had come to acquire a decisive competitive edge in trade in services. That partly explained the US insistence on bringing trade in services and Trade Related Investment Measures (TRIMs), within the scope of the new round of trade negotiations.

Another area in which the United States perceived itself to be competitive was agriculture. Here, its interest coincided with that of some of the other low-cost agricultural producing countries. This led to the formation of the CAIRNS Group of both developed and developing countries, committed to seeking maximum liberalisation in agricultural trade. That is how agriculture became a key issue in the negotiations, not only as a major bone of contention between the United States and the European Community (EC) but also having the effect of breaking the rank of the developing countries.

In the beginning, the developing countries were reluctant to get involved in another round of trade negotiations so soon after the last round from which their gains were rather limited and yet to be implemented. Some of the specific tasks remaining after the Tokyo Round were reaching an agreement on non-discriminatory safeguard measures, phasing out the Multi-Fibre Agreement (MFA) and eliminating other grey area measures, and removing restrictions on the access of their tropical products. Developing countries were also very much concerned about the implications of the efforts of developed countries to bring on the GATT agenda new areas of negotiation, such as Services, TRIMS and Trade-Related Intellectual Property Rights (TRIPS), and considered them as an intrusion into their sovereign macro-economic decision-making. In the Programme of Action that emerged at the end of the GATT Ministerial Meeting in November 1982, the developing countries succeeded in substantially underplaying such new areas and keeping the limelight focussed on the issues of interest to them.

The developed countries, while paying lip-service to the 1982 Programme of Action, fully used the GATT forum for putting relentless pressure on the developing countries for launching a new round of trade negotiations. The only area of interest to them being market access, the developing countries tried to resist the new round, as long as they could. They were ultimately obliged to yield in Punta del Este in September 1986 when the Uruguay Round was launched. By that time their unity and cohesion had been severely dented. Consequently, at Punta del Este, a group of only 10 developing countries including India was left to defend the interest of developing countries as a whole.

The new issues introduced by the developed countries into the negotiations were not of the traditional nature, involving simple exchange of trade concessions. They were either in the realm of domestic macro-economic decision-making or had far-reaching external implications. The developing countries, had taken common positions on related issues, like transfer of technology, dealings with transnational corporations, etc., in the relevant international fora. This precedent should have warranted these countries adopting a common strategic position on these issues in the GATT forum. Unfortunately, no such strategy could emerge because of a variety of reasons.

Owing to the harsh economic conditions of the late 1970s and early 1980s, the development process in a large number of these countries had either come to a standstill or suffered serious set-backs. Many of these countries had to go to the International Monetary Fund (IMF) and the World Bank for monetary and financial accommodation. By the time the Uruguay Round was launched, more than half of the developing countries had become dependent on developed countries and on the IMF and the World Bank, on their behalf, for repeated rescheduling of their debts. In forcing the Uruguay Round, with its agenda of the new areas of negotiation, the developed countries fully exploited this vulnerability and succeeded in breaking their unity. The United States effectively used the Super and Special 301 measures to force a change in the negotiating stance of important developing countries. By the mid-1980s, the Non-Aligned Movement (NAM) and the Group of 77 had also ceased to be forums for effective joint action. The developing countries had begun to wilt under bilateral pressure and give up the position of common interest.

In arguing for the new round, the developed countries repeatedly stressed that what was at stake was the very future of the multilateral trading system, that protectionist measures against the exports of developing countries would be intensified, and that there would be a multiplication of exclusive trading arrangements and withdrawal from the GATT system, reducing the multilateral trading system to chaos.

The tenuous unity of the developing countries in the form of the group of 10 was maintained almost until the end of the review of the negotiations at the Ministerial level in Montreal in December 1988. Developing countries undertook a damage limitation job in the new areas of negotiation, such as Services, TRIMs and TRIPS. They sought to improve the prospects of their textile exports in the markets of developed countries, to strengthen the safeguards arrangement and the dispute settlement mechanism under GATT and, finally, to lodge the possible regime on services outside the GATT, so as to prevent cross-retaliation. The fragile unity of the South in the Uruguay Round collapsed at the resumed mid-term review of the negotiations in Geneva in April, 1989.

Until the last days of the resumed mid-term review session, India had firmly adhered to the position that GATT was not the forum to discuss norms and standards of Intellectual Property Right (IPR) protection nor could a higher level of IPR protection be a part of a liberal multilateral trading system. Then came the sudden reversal of India's position in Geneva. What led to the shift in Government of India's position has to remain a mystery for sometime to come. The argument given in justification of this turnabout in policy is that India found itself isolated in Geneva. However, the issue is not whether India was isolated, which might as well have been the case, but how this isolation came about. The fact is that we ourselves brought this isolation upon us as a part of a conscious polity. From December 1988, the word passed on to the Indian delegation at the political level was that India should not try to be on the vanguard of the struggle of the developing countries and should leave the leadership role to some other developing country or countries. Consequently, at Montreal, the Indian delegation did not even take the initiative of convening a meeting of the like-minded developing countries to adopt common positions on various issues.

India's retreat in Geneva came as a surprise to many developing countries, particularly from Africa. They knew that they were too vulnerable to put up a credible fight, but they somehow believed that India was the only developing country capable of offering resistance on their behalf.

Between the launching of the Uruguay Round in 1986 till its formal conclusion in the Marrakesh Ministerial Meeting in April 1994, more than 60 developing countries reported unilateral liberalization measures to GATT, 24 acceded to GATT and 24 others were in the process of doing so [World Bank, 1994]. By the and of 1991, the then Director General of GATT, Arthur Dunkel, presented a Draft Final Act, embodying what he thought could be the agreed outcome of the Uruguay Round. This was offered as a single treaty no element of which could be considered as agreed until the total package was agreed. The persisting differences between the EC and the United States on the Agreement on Agriculture, the attempt of Japan to retain its rice protection policy, difference between the US and France on the extent of liberalisation of cinematic material, the attempt of the United States to still tighten the noose round the developing countries in the area of TRIPS and their import of textiles from developed countries, combined with domestic political developments in some of the major developed countries, resulted in a further delay of two years.

During the best part of this period, the Government of India did not take any step known to the public, to renegotiate on issues of interest to India. No indication was given to the Parliament or to the public that the minimum 'must', which India should have taken up for renegotiation, had been identified. Nor was there any indication that either the Director General of GATT or major negotiating partners had been notified of India's negotiating position. On the contrary, the notes prepared and the statements made by the Government of India sought to bring out the great virtues of the Draft Dunkel Text from the point of view of India and gave reasons why India should sign this text on the dotted lines. During this period, the Government of India also stuck to its policy of not taking any initiative to mobilise the support of other developing and like-minded countries, to bolster its position. It was only towards the end of 1992, and that too under the strong pressure of nation-wide agitation mounted against some of the key provisions of the Dunkel Text, that the Government of India bestirred itself and identified a few issues in which our interest needed to be protected. But that was too little and too late. There was no substantial change in the Dunkel Draft as finally adopted, from the point of view of India's interest.

The Final Act embodying the results of the Uruguay Round was ultimately agreed to on December 15, 1993 and formally approved and signed at the Ministerial level in Marrakesh, Morocco, on April 15, 1994. After the receipt of the necessary number of ratifications, the Agreement for WTO came into effect from January 1, 1995.

The Uruguay Round was different from all previous rounds of trade negotiations under GATT in several ways. Firstly, this was the only round of trade negotiations which the developing countries went on resisting for several years and when they ultimately did agree to its being launched, they saw their main task as minimizing the damage, and a rationalization of the inevitable.

Secondly, these were the first GATT trade negotiations in which the developed countries, apart from seeking the liberalization of the agricultural trade in all countries, targeted the markets and the economic playing fields of a dozen or so large-size and more developed among developing countries, including India, for seeking liberalisation for their goods and services. This circumstance gave to these developing countries a bargaining power to the kind they had not enjoyed in any of the previous rounds of trade negotiations which were conducted mainly among the 'principal suppliers' and in which the concessions exchanged in the process were extended to all others on the basis of the Most-Favoured-Nation principle. Developing countries lamentably failed to take advantage of this unique bargaining power mainly because, under the pressure of the IMF and World Bank, they were already committed to a much more extensive programme of unilateral liberalization than that involved in the Uruguay Round.

Thirdly these were the most far-reaching negotiations ever undertaken under the GATT. For the first time, it brought under the discipline of GATT agriculture and the new areas of TRIPS, TRIMs and Services. The Final Act includes as many as 19 new Multilateral Agreements on Trade in Goods, 4 Plurilateral Trade agreements, an Agreement each on TRIPS and Services, an Understanding on Dispute Settlement, an Agreement on Trade Policy Review Mechanism and numerous Decisions and Declarations adopted at the Marrakesh Ministerial Meeting.

Finally, these were also the first GATT trade negotiations which went beyond the traditional GATT jurisdiction of regulating trans-border trade transactions and paved the way for a massive intrusion into 'the sovereign economic space' of the developing countriesby providing for right to establishment and operation in the sovereign territory of other states and moderation in the macro-economic policies followed by Member States, upsetting their development priorities and inhibiting their pursuit of self-reliant growth based on the maximum utilisation of their own material and human resources.

II. GENERAL ASSESSMENT OF THE OUTCOME

A brief and rough balance sheet of the advantages and disadvantages from the Uruguay Round for India is given below:

Advantages

Benefits from reduction of tariffs on the products of export interest to India.

Improved prospects for agricultural exports as a result of likely increase in the world prices of agricultural products, due to reduction in domestic subsidies and barriers to trade.

Likely increase in the export of textiles and clothings, due to the phasing out of the MFA by 2005.

Advantages from greater security and predictability of the international trading system, due to the revamped dispute settlement procedures and the agreements on Safeguards, Subsidies and Anti-Dumping Measures, and from compulsion imposed on us to be competitive in the world market.

Disadvantages

Tariff reductions on goods of export interest to India are very small. On the other hand, there will be erosion of the preferences enjoyed by India and India will most probably be graduated out of the Generalised System of Preferences (GSP).

Meagre prospects of increase in agricultural exports due to the very limited extent of agricultural liberalisation.

There will be hardly any liberalisation of our textile exports during the next 10 years, with most of the liberalisation expected to come at the end of this period.

We will be put under tremendous pressure to liberalise our services industries.

There will be only marginal liberalisation of the movement of labour services in which we are competitive.

We will lose policy options in several areas because of (i) the extensive bindings undertaken by us, (ii) prohibition of certain types of subsidies and making certain other types actionable, (iii) giving up the option of granting process patents only in some sectors, and (iv) limitations put on our ability to apply restrictions on balance of payments ground.

Increased outflow of foreign exchange due to commitments undertaken in the field of TRIPs, TRIMs and Services.

Technological dependence on foreign firms will increase as the Research and Development (R&D) required to take advantage of the Uruguay Round may not be undertaken on an adequate scale due to paucity of resources.

Concentration in market structure whereby only a few large firms or transnational corporations may benefit and smaller and tiny firms may disappear.

Increasing intrusion in our sovereign domestic space in TRIPs, TRIMs, Services and Agriculture.

The Uruguay Round has paved the way for similar other intrusions in future through linkages between trade and environment, trade and labour standards, and a new regime for the treatment of foreign capital.

Trend towards neo-protectionism in developed countries against our exports.

Possibility of cross-retaliation against our export of goods and services.

Several assessments, mostly of a quantitative nature, calculate the loss or gain of the Uruguay Round in terms of overall export expansion, growth in Gross National Product (GNP), etc. On the whole, they do not provide a reliable basis for reaching any firm conclusions because of their inherent limitations, such as use of different models with different sets of assumptions, and of different time horizons. Besides, some of the changes in trade policies would have taken place autonomously under the momentum of structural adjustment programmes.

The GATT Secretariat has estimated that as a result of the Uruguay Round agreements, world trade will grow by $257 billion per annum by 2000 A.D. From this figure it has been facilely calculated that there will be an increase of $1.5 billion to $2 billion per annum in India's exports by the year 2000. This is apparently based on the assumption that India's share of world exports will increase from its present level of 0.5 per cent (1991 figure) to 1 per cent by the year 2000. This calculation of export benefit to India suffers from several infirmities. Firstly, the GATT estimate of increase in world trade is itself of dubious value. Secondly, in the face of a trend till recently of a decline in India's share of the world exports, it is unrealistic to assume that this share will go up to 1 per cent by the end of the century. Finally, increase in world trade depends not only upon trade liberalisation, but also upon a variety of other factors such as the micro management of exports, level of technology, level of human resources development, etc. This is particularly true in the case of India where export efforts suffer from lack of or poor infrastructure, absence of quality consciousness, supply bottlenecks arising, among others, out of unmet domestic demand, and from tariff differentials and currency fluctuations. Besides, the gains to developing countries are likely to be long delayed because of the long period of phasing out of some of the restrictive measures, particularly the Multi Fibre Agreement (MFA).

Given the extreme uncertainty in the world economic and political situation, even the best of projections is a risky game. Projections become pernicious if the intention is to mask reality and indulge in half truths. Many of the assumptions behind the projections change even in the short and medium term. All the estimates indicate that the African countries are going to be the biggest losers from the Uruguay Round negotiations [OECD, 1994]. Exports of tropical products from the African, Caribbean and Pacific States (ACP) will suffer the heaviest loss in terms of preferential treatment - as much as by 51 per cent. For developing countries in general, as a consequence of the Uruguay Round cuts, preferential margins will totally disappear in some sectors. In several cases, MFN rates are now below the rates of the Generalised System of Preferences (GSP). Because of these changes and other features like graduation, application of political criteria such as disarmament and labour standards - introduced by major developed countries in their GSP schemes - GSP is no longer a reliable or achievable tool for the expansion of the exports of developing countries.

Regarding the tariff reductions agreed to in the Uruguay Round, tariff cuts on goods of export interest to developing countries are less than those on goods of export interest to developed countries. For example, in developed countries, tariff reductions for industrial goods average 38 per cent for imports from all origins, but only 34 per cent for imports from developing countries [GATT, 1993]. Average reduction in tariff during the negotiations is calculated to be 38 per cent, though the reduction in the tariffs on goods of export interest to developing countries is going to be only about 30 per cent as against 56 per cent reduction in the tariffs on goods of export interest to developed countries [GATT, 1993]. The escalation of tariff rates according to the degree of processing will remain high on several product groups of export interest to developing countries, particularly leather, coffee, tea, jute, fabrics, cocoa products and tropical fruits. Cuts in high tariff goods - clothing, rubber, shoes, travel goods and transport equipment - have been very small.

Integration into GATT of the trade in textiles within 10 years after the Agreement on Textiles goes into effect back-loaded in that the bulk of the liberalization will come at the end of the period. The stipulated reduction in the internal support for agriculture and in the trade barriers will, no doubt, lead to an increase in world agricultural prices, thus making agricultural exports of the developing countries more competitive. However, the fact remains that the reductions agreed upon are very modest.

The provision on safeguards, anti-dumping measures and subsidies will make for greater transparency. The revamped dispute settlement mechanism would make for greater predictability and security but this depends entirely on how it is used. Here the bargaining positions of the contending parties is going to be of crucial importance. Moreover, the dispute settlement mechanism will for the first time enable developed countries to cross-retaliate against developing countries, for example to withdraw concessions on the export of their goods in retaliation if they fail to live up to their commitment for the liberalization of trade in services. The developing countries, on the other hand, made major concessions in the Uruguay Round by accepting new and rigorous multilateral disciplines in the new areas and substantial erosion, if not disappearance, of the differential and more favourable treatment provided for them in Part IV of the GATT and reiterated in the Punta del Este Declaration. In the Final Act, the differential and more favourable treatment promised in the Punta del Este Declaration has been reserved for the least developed among developing countries, largely because this group of developing countries, on account of their extreme vulnerability, pose no competitive threat to the developed countries. The developing countries in general including the least developed countries will have no separate regime and no exception or waiver from the general rules other than those permitted to developed countries. They have been given merely some relief by way of longer transitional period and lower level of liberalization commitment in agriculture but, in general, they have to assume all the obligations and join all the regimes provided for in the different agreements of the Final Act on par with developed countries.

The provisions of Article XVIII on Government Assistance to Economic Development and Part IV of GATT on Trade and Development still exist on paper. But they will gradually become ineffective as a major thrust of the Final Act is to do away with the special privileges and the positive discrimination the developing countries have so far enjoyed under GATT. Now measures of positive discrimination, such as non-reciprocity, preferences, and other forms of assistance for development, cannot be taken for granted. These can henceforth be obtained only by negotiation and after the payment of *quid pro quo*. This is very clear from the provisions in the General Agreement on Trade in Services (GATS) where every form of flexibility for an assistance to developing countries is subject to negotiation, and where no provision is made for developing countries to apply import restrictions on protectionist ground - a privilege which developed countries have so far enjoyed in the services sector.

And finally and most importantly, the new order will result in foreclosing, for developing countries, several of the policy options and instruments that today's developed countries have been able to use for decades until a very late stage of their economic development, in order to accumulate capital and knowledge, attain self-sufficiency and export surpluses in production and reach the present level of affluence. Given the same starting points, they have had much longer time margins under government patronage and behind protectionist walls, than they seem to be inclined to grant for the developing countries.

In the Uruguay Round the developing countries have undertaken extensive commitments of an irrevocable nature in diverse areas. They have abandoned several of their restrictive and discretionary trade and industrial policy tools and accepted new disciplines in areas previously beyond the pale of any international regime. To give only a few examples, the developing countries have bound 72 per cent of their industrial tariff lines as against 22 per cent prior to the Uruguay Round [GATT, 1993]. In agriculture, the bindings of the developing countries increased from 22 per cent to 100 per cent, as against the increase in the bindings of developed countries from 81 per cent to 100 per cent [GATT, 1993]. Binding means effectively ending freedom to turn back to the protectionist instruments of the past. In the Agreement on Subsidies, the developing countries have undertaken a commitment to eliminate subsidies having an impact on export prices. This means that they have lost one of the most important instruments for pursuing a policy of export-led growth which the present developed countries followed for decades and the newly industrialised countries followed up to the present.

The ability of the developing countries to impose quantitative restrictions for balance-of-payment purposes will be severely curtailed and all such existing restrictions will have to be phased out within a time limit. They would no longer be able, in effect, to impose such restrictions for protectionist purposes and broader developmental purposes as they were entitled to do under Article XVIII of the GATT. Above all, they have accepted far-reaching obligations and restrictions on domestic policy actions in such areas as intellectual property rights, services, agriculture, etc., at a much earlier stage of their development.

III. TRADE-RELATED ASPECTS OF INTELLECTUAL PROPERTY RIGHTS (TRIPS)

Until the early 1980s, protection of intellectual property rights was never considered as an aspect of a trade regime. Nations, both developed and developing, recognised that for both, as a reward and as an incentive for innovation, it was necessary to make payments for intellectual property rights, particularly patents. But the public interest took precedence over the interest of the patent-holder. There was greater emphasis on using patents as a means for seeking transfer and indigenous development of technology and as a tool for industrialisation. The public interest also warranted steady and adequate supplies of patented products at reasonable prices. For these reasons, several nations enacted patent legislations providing for compulsory licensing for the working of the patent, i.e., local manufacture of the patented product and for the grant of process patent only in sensitive sectors of the economy.

Several developing countries, including India, did not adhere to the Paris Convention for the Protection of Industrial Property (1967), because they thought that it would come in the way of their industrialisation policy. During the late 1970s and the early 1980s, at the initiative of UNCTAD, the developing countries tried to bring about changes in the Paris Convention mainly in order to make the working of the patent as an obligation of the patent-holder and, generally, to reflect their development needs and priorities. But this exercise turned out to be infructuous. However, from the beginning of the 1980s, the major developed countries, particularly the United States, seized the initiative and went about systematically reversing the direction of change from greater flexibility in national patent systems, to take care of varying needs and levels of development, towards a tightening up of such systems.

One of the motives of the United States was to prevent the newly industrialising countries from catching up with the US lead in technology by what the US regarded as the widespread piracy and counterfeiting of the innovations of the US companies. The USA regarded the very open technological and scientific system prevailing at that time as inimical to its interest in this area. The monopoly position to be granted by a higher level of protection of IPRs was seen as an instrument to neutralise in part the relative decline in US competitiveness and to prevent further catching-up based on an approach of imitative industrialisation.

Also new knowledge and technology are now-a-days diffused more rapidly. Capabilities to absorb new knowledge have increased worldwide. Besides, the new technology is knowledge-intensive, in a sense, an intangible asset whose flows are more difficult to control. Technological leaders consequently wish to strengthen the private character of new knowledge. Moreover, the most dynamic economic sectors are those linked to new technologies. The ability to control the diffusion of such technologies permits the technological leaders to keep control over the most dynamic economic sectors.

Besides, growing investments by the transnational corporations and other private sector enterprises in the North on research and development calls for quasi-rent through a more stringent regime of intellectual property rights. With increasing globalisation, governments of developing countries wanted to impose obligations on the corporations to work a patent and transnational corporations wanted to eliminate such requirement and other conditions on the exercise of IPRs. The governments of developed countries openly sided with their transnational corporations and mounted a campaign to safeguard their interest, The Agreement on TRIPS was the culmination of this effort. The TRIPS Agreement is thus a movement in the opposite direction from the draft Code of Conduct on the Transfer of Technology negotiated in the UNCTAD, and the draft Code of Conduct for Transnational Corporations negotiated in the United Nations, both of which were designed to require transnational corporations to transfer technology to developing countries and to function in conformity with public interest and national development objectives and priorities of the host country.

In Geneva in 1982, the developing countries called for a discussion on the clarification of the existing GATT rules and provisions dealing with intellectual property rights, and with the measures to restrict trade in counterfeit goods. They, however, regarded any discussion of norms and standards of IPRs as beyond the competence of GATT. Under extreme pressure from the developed countries, including the threat of unilateral trade sanctions under the Special 301 section of the US Trade Act, they agreed for the first time to discuss norms and standards of IPRs in Geneva in April, 1989.

After that, developing countries took a negotiating position which was aimed at safeguarding their interest to the maximum extent possible, particularly with regard to the scope, extent and duration of patent protection. But the negotiations on TRIPS turned out to be asymmetrical and non-transparent. No opportunity was provided to the developing countries for serious bargaining with developed countries and for a trade-off between the losses to be suffered by them on account of accepting a higher level of IPR protection and gains in terms of compensatory provisions in the area of TRIPS or other areas of Uruguay Round negotiations. The finally arbitrated text in the Dunkel Draft came as a big surprise to developing countries.

The TRIPS Agreement basically universalises the levels of IPR protection now prevalent in the developed countries. Protection will be available for 20 years for patents and 50 years for copyrights. And the protection of IPRs provided in the Agreement will be enforced through the common Dispute Settlement Mechanism of the WTO, which provides for retaliation and cross-retaliation. The TRIPS Agreement opts for copyright protection of software and data base, as though these are literary works under the Berne Convention. In addition, patents will be available in the area of computer development and information technology. Patent protection in these areas would impede both the independent development of functional equivalents and reverse engineering, while enhancing the market power of large firms which, through cross-licensing agreements, might erect barriers to entry that smaller firms will find difficult to overcome. The TRIPS Agreement goes against the Patent Act of India in practically all important respects. For implementing the TRIPS Agreement, a total revamping of the Indian Patent Act will be required.

The protection of intellectual property rights is no part of liberal multilateral trading system. IPR protection is anti-competition and anti-liberalisation, as it is intended to guarantee the rentier's income to the monopolists in this area. The main reason for bringing the protection of IPRs under GATT was to secure the right to use the GATT retaliatory trade sanctions, because other enforcement mechanisms at the national and international levels were proving ineffective and inadequate. In fact, the protection of intellectual property rights can itself be a barrier to trade. This is recognised in the Agreement on TRIPS in the first paragraph of its Preamble, further also in Article 8(2) of the Agreement. In spite of this, the Agreement does not contain any binding or enforceable measures to prevent abuses. On the contrary, the text of the Agreement is weighted heavily in favour of patent-holders who will have under the Agreement all the rights they claim, but hardly any obligations.

Purely in economic terms, global welfare deteriorates with higher level of intellectual property protection. In extending patent protection, a society incurs costs in terms of inefficient factor allocation and in the form of monopoly profits paid to investors. There is also a distortion of consumer's choice due to monopoly pricing. Moreover, patent protection conflicts with consideration of equity, for it involves a substantial transfer of welfare from developing to developed countries. Technology having emerged as the most potent factor for economic growth, the technological gap between developed and developing countries is the critical factor responsible for the overall economic gap between these two groups of countries. Technology is also the strategic element for gaining control over global production and distribution of goods and services. The net effect of the provisions in the Agreement on TRIPS will be to freeze the present technological asymmetry between developed and developing countries. It will consolidate a system of an international division of labour under which developed countries will generate technology and developing countries will provide the markets for the resulting goods and services. The higher level of IPR protection provided in the text will perpetuate the near monopoly of developed countries of knowledge and technology and prevent newcomers from threatening this monopoly position. Viewed in this context, the TRIPS Agreement is nothing but an instrument of technological protectionism.

Most of the present developed countries introduced product patent in important and sensitive sectors of their economy only after reaching a fairly high level of industrialisation. UK did so in 1970, Germany in 1968, Japan in 1976, Italy in 1978, Switzerland in 1977 and Sweden in 1978. The TRIPS Agreement prohibits the present practice in many developing countries and the erstwhile practice in several developed countries, of granting process patent only in such areas as pharmaceutical, chemical, food-processing, etc. This will adversely affect the policies of technological self-reliance. It will prevent the development of processes appropriate to the domestic environment, socio-economic conditions and the resources endowment of developing countries. More specifically, it will prevent the so-called 'reverse engineering' which several of the present highly developed countries have resorted to, in order to reach the present level of sophistication of their industrial and technological structures. It will be a strong disincentive to local R&D effort because a large part of the present process of making incremental innovations on technologies acquired from abroad will be declared illegal and, hence, will have to be dismantled.

According to Article 46 of the Agreement, goods produced in units operating on the basis of a system of process patent only and the resources and implements used for producing such goods may be ordered to be destroyed or dismantled. Indian companies have successfully explored alternative technological routes to produce the same products. It was made possible by the process patent only regime. Superior Indian formulations are the cheapest in the world. Now India will be required to close down some 10,000 units in the pharmaceutical sector, throwing out of employment thousands of scientists and technicians and adversely affecting an export business of approximately $ 550 million per annum. Foreign entrepreneurs would displace local firms, particularly in areas of very advanced technology and there will be a sharp increase in the profits and royalties remitted abroad.

Strong protection of IPRs is likely to be used by foreign patent-holders to preserve their import right than to work the patent locally. Even in working the patent, their enhanced monopoly position and hence bargaining power, thus allowing them to charge higher prices, will hurt the developing countries more because as compared to developed countries they are to a far greater extent users rather than generators of technological innovations. Also, higher level of IPR protection will impose additional burden on their balance-of-payments position; they will now be importing goods which they have been producing domestically through reverse engineering.

The welfare loss to a sample of developing countries, i.e., Argentina, Brazil, India, Mexico, Korea and Taiwan, due to higher level of IPR protection provided in the TRIPS Agreement would range from $ 3.5 billion to $ 10.8 billion, while the income gains by foreign patent-owners would be between $1.2 billion to $ 14.4 billion [Julio, 1990]. Countrywise annual welfare losses, according to various estimates, would be $ 67 million to $ 387 million for Argentina, $ 220 million to $ 1.3 billion for India, $ 153 million to $ 879 million for Brazil and $ 75 million to $ 428 million for Mexico [Harmsen and Subramanian, 1994].

Most of the national patent laws have provided - and several of them still provide - for compulsory working of patents, in order to ensure that essential products for which patents have been granted can be made available to the people in sufficient quantities and at reasonable prices. The TRIPS Agreement contains no explicit provision for compulsory licensing. A measure of involuntary licensing is implicit in Article 31 of the text under the title 'Other Use Without Authorisation of the Right Holder' under exceptional circumstances for a limited purpose of non-commercial use only and for limited duration. A number of conditions must be fulfilled before 'use without authorisation' is made. All these stipulations, i.e., reasonableness of terms and conditions and of the time period, adequacy of the compensation offered, etc., are subject to judicial review. Further, the provision in the TRIPS text of 'use without authorisation' is virtually pre-empted by another provision in the text (Article 27(1)) which states: '....patents shall be available and patent rights enjoyable without discrimination ..... as to ..... whether products are imported or locally produced'. In other words the import of the product will be as good as producing it by locally working the patent. This gives *carte blanche* to the right-holder not to work the patent locally and go on supplying the market by imports. It will no longer be possible to use prolonged non-working as a ground for giving a compulsory licence.

There is no evidence to show that a higher level of protection of IPRs brings in larger flows of foreign private investment and technology. A UN study has brought out that innovating companies of developed countries prefer selling their products directly to transferring technology through foreign direct investment [The United Nations, 1993]. It is also simplistic to believe that there would be an outburst of inventive genius in developing countries once they raise the level of IPR protection in their territories. An invention is not just one stroke of genius; it is a result of centuries of research. Invention, above all, requires skilled manpower, technological infrastructure, and investment in R&D. The transnational corporations of developed countries, by virtue of their command over global resources, global production and global market, have a decisive advantage over the governments and the enterprises in developing countries. The example of India shows that invention has been possible not by the grant of product patent but by the dedicated effort of a group of scientists, by a mission approach and by selective delinking as in the case of nuclear and space technologies.

IPRs, particularly patents, constitute a contract that grants monopoly privileges for a limited number of years as a reward not only for the invention *per se* but mainly for the public disclosure and diffusion of the invention. The very meaning of the word 'patent' is to make known. That is why the phrase: to make patent what is latent. Social benefits of a new knowledge lie more in its diffusion throughout the society than in its mere creation. A higher level of IPR protection seeks to prevent this diffusion. The intention to restrain the diffusion of new knowledge is also emphasised by the acceptance of trade secret as qualifying for protection. Until recently, it was only under the US IPR laws that they were protected, now it has become a part of the international regime under the TRIPS Agreement. The role of IPR as a mechanism to stimulate invention and innovation has been exaggerated, while the great social benefit that is derived from the diffusion of the new knowledge and the external economies, that such a diffusion creates, are neglected.

There is also, no doubt, that in those developing countries where drug prices have been dramatically brought down through the invention of local formulations based on a policy of process patent only in the pharmaceutical and chemical sector, the introduction of product patent along with the other provisions of the TRIPS text will lead to a substantial increase in the prices of life-saving drugs, most of which are covered by patents. In India, it is extremely important to make drugs available to the people at low prices. Our lower drug prices have been a mainstay of our health-care system and our strategy for achieving the goal of 'health for all'. The introduction of product patent in this sector will deal a severe blow to our effort in the field of public health services. In an exercise carried out in 1994 which compares the prices of patented drugs in Malaysia (where patent protection for pharmaceuticals is reasonably high) with those in India (where it is not), it has been found that the Malaysian prices are 17 to 767 per cent higher than those in India [Subramanian, 1994].

The argument that the consumers in the domestic market can switch from the more expensive on-patent drugs to less expensive off-patent drugs is misplaced. For, there is no consumer's sovereignty in the market of life-saving drugs. The patient follows the doctor's prescription and the doctor prescribes under the influence, both direct and indirect, of the sales drive of the drug companies. The problem of prescription is further compounded by the fact that the therapeutic value of a new patented drug is never exactly the same as that of the old off-patent drug. There is always some improvement which becomes the critical factor in selecting a drug. Moreover, even after the patent expires, the original innovator is able to maintain, through brand loyalty, prices higher than those that would prevail in the absence of the patent. Any drug price control regulation prevailing in a developing country will not be of much use. The importers cannot be forced to sell the drugs, they would import, at prices 5-10 times lower than what they would have paid. Of course, the government can subsidise the price; but this will be at the cost of the exchequer.

With regard to pharmaceutical and agricultural chemical products, the TRIPS Agreement effectively, even if not nominally, provides for pipeline protection. Pipeline protection is given to those patents for which an application is pending in one member country and for which patent has been granted in another member country and marketing approval obtained in the latter country. Article 70(8) of the agreement obliges member states to provide, as from the date of entry into force of the WTO Agreement, a machinery for the filing of applications for patents for inventions in the pharmaceutical and agricultural chemical sectors. However, the application will be considered on the basis of the criteria for patentability laid down in the Agreement and it is presumed that action on the application need not be taken until after the expiry of the transition period of ten years in respect of such products, for the developing countries. This would appear to rule out any obligation to grant pipeline protection. But paragraph 9 of the same Article provides that once an application for patent protection in these areas has been filed and a patent is granted for that product in another member country and marketing approval obtained there, 'exclusive marketing rights' (EMRs) shall be granted for a period of five years. This will enable the patent holder to enjoy monopoly rights even if proper patent protection may not be granted until after the expiry of the interim period. The provision of 'exclusive marketing rights' confers as much a monopoly right as does a patent. This provision makes the 'transition period' for the developing countries an empty promise. To give effect to the provision on pipeline protection through the grant of exclusive marketing rights, the Government of India introduced the Patent Amendment Bill, 1995, in the Parliament. The Bill was passed by the Lok Sabha but is held up in the Rajya Sabha.

The problem with giving EMRs under the conditions laid down in the TRIPS Agreement will be that its effect will be the same as of granting patent rights and yet it will not be necessary to follow such rigorous scrutiny of the application as will be done if patents were to be granted. Exclusive marketing rights will have to be given if a patent or marketing approval has been taken in any other member country. That country may not have an adequately developed chemical industry or a testing facility. This will mean that new drugs will be introduced in India without any proper chemical trial. This will be injurious to public health. Besides, giving exclusive marketing rights means that the patent will not be made public and no objection will be invited. And yet, local invention in the product will be pre-empted. The best thing for the Government of India to do will be not to allow an application to lie in the black box, but to examine it as though a patent has to be given without much delay. The Government should go through the whole drill of examining the application, notifying it and inviting public objections, even though what is involved is the granting of EMRs and not a patent.

Another significant feature of the TRIPS Agreement is that it provides for a reversal of the burden of proof in the case of process patents. Article 34 of the Agreement stipulates that in the case of a complaint of infringement of a patent right, the judicial authorities can oblige the defendant to prove that the process used to obtain an identical product is different from the patented process.

Patenting of Plant Varieties

One of the most far-reaching provisions in the TRIPS Agreement is that relating to the patenting of plant varieties. In developing countries, protecting the farmers' rights to use their own seeds and to propagate high-yielding and pest-resistant varieties to other farmers is key to increasing agricultural production and attaining food self-sufficiency. Besides, generations of farmers since time immemorial have been responsible for the discovery of genes and for their development to their present stage of maturity and variety. They have, therefore, a right to claim their legitimate share by virtue of their past contribution to the development of new plant varieties. It will be unfair if a breeder who effects some mutation in the plant, already discovered and brought to the present stage by farmers, is allowed to acquire an exclusive right on the new plant variety. But this is precisely what the TRIPs text provides by way of 'protection of plant varieties'. The discretion to individual countries to have an effective *sui generis* system of their own is impractical and can only make for international anarchy in this field.

Therefore, the effective *sui generis* system adopted by individual countries will be expected to conform to an international norm and that norm is provided in the Convention for the Protection of New Varieties of Plants, which is commonly known as UPOV, its French abbreviation. Most of the developed countries adhere to UPOV as amended in 1978. The Treaty has, however, been further amended in 1991, but has not come into force pending its ratification by the requisite number of countries.

Both UPOV-1978 and UPOV-1991 are designed basically to protect the breeder's rights, and not the farmer's rights. Breeder's rights provided in UPOV-1978 permit the use by other breeders of a protected variety as a basis for the development of a new variety ('the breeder's exception') and the re-use by the farmers of seeds obtained form their own harvests ('the farmer's privilege'). But in UPOV-1991, a much higher level of protection is provided to the breeders, generally at the cost of the farmers. Farmer's exception has lost its character as a general principle and has become a real exception to be established in each case. A comparison between UPOV-1978 and UPOV-1991 is attempted below:

Comparison Between UPOV-1978 and UPOV-1991

1. UPOV-1991 dispenses with the Preamble of UPOV-1978 which refers to 'the limitations that the requirement of public interest may impose on the free exercise of breeders' rights'.
2. UPOV-1978 makes its provisions applicable within 8 years to at least 24 genera or species in all, while underlining the objective to cover progressively all genera; UPOV-1991 obliges a member state to apply its provisions to all plants and genera, within five years after it becomes a party to the treaty.
3. In UPOV-1978, restrictions on the exercise of breeders' rights are 'for reasons of public interest'; in UPOV-1991 exceptions are spelt out in functional terms, such as acts done for experimental purpose, acts done for the purpose of breeding other varieties, etc. The latter category includes use by farmers for propagating purposes on their own holdings, the product of the protected variety obtained by planting on their own holdings. But this exception must be 'within reasonable limits and subject to the safeguarding of the legitimate interest of the breeder'.
4. In the Article on the rights of the breeder (Article 5 of UPOV-1978 and Article 14 of UPOV-1991) UPOV-1991 mentions the following additional acts in respect of the propagating material of the protected variety, which shall require the authorization of the breeder: 'reproduction', 'conditioning for the purpose of propagation', 'exporting', importing' and 'stocking' for the purposes specified in Article 14. These might have been implied in Article 5 of UPOV-1978, but are not specifically spelt out.
5. The period of protection under UPOV-1978 is 15 and 18 years; under UPOV-1991, it is 20 and 25 years.

In formulating their *sui generis* system, the developing countries would be expected to conform, perhaps only for the time being, at least to UPOV-1978. That is how the 'effectiveness' of their *sui generis* system will be judged. And as there is a provision in the TRIPS text for a review after four years, they would be expected then to adhere to UPOV-1991 which, it will be then said, is the only system providing 'effective' protection. In the world of commercialised agriculture in developed countries, the evolution is clearly toward higher and higher level of protection of the breeder's rights. The developing countries will be pressurised to follow the same path, in order to pave the ground for multinational seed corporations' entry into their markets. In the process, the rights of the farmers in these countries will be sacrificed. Developing countries, by and large, have not developed any commercial interest in the marketing of seed varieties nor are most of them likely to be able to develop such an interest in the face of competition from multinational companies.

Under the provision on the protection of plant varieties, once farmers decide to use a protected variety, they would no longer be able to make seeds out of their produce of this variety available to other farmers on a commercial basis. Other farmers will have to go to the firm which can supply the protected variety. The prevailing practice among farmers in most of the developing countries is that of obtaining a large proportion of their seeds requirement from other farmers. In India, the proportion is as high as 70 to 80. It was the unimpeded and uncircumscribed freedom of the farmers to obtain improved varieties of seeds from all available sources, including other farmers, which was in no small measure responsible for the low cost of the improved varieties of seeds and the rapid propagation of such varieties - the factors which played such an important role in bringing about the Green Revolution. Farmers may be free to use any of the hundreds and thousands of varieties which are locally available and for which no patents have been taken. But they are vulnerable to the advertisement and sales propaganda of the multinational seed companies. Moreover, if they want to produce for exports, they would be obliged to use the seeds of varieties that are globally traded, internationally standardised, and quoted in the global market. Moreover, because of rapid environmental depredation, a process of fast depletion of plant varieties has already set in motion.

Through the patenting of plant varieties, the patent holder will be able to replace the plant itself, thereby rendering infructuous the provision in the TRIPS Agreement on non-patentability of plants, animals and biological material found in nature. If the essential traits of a plant variety, e.g., higher oil content, disease resistance, higher yield, etc., can be patented, then very little will remain in the original plant for people to crave for it. Biotechnology has revolutionary potentials for bringing about economic transformation. Because of their rich bio-diversity resources, developing countries have the best chance of catching-up with developed countries through the bio-technological route. But the TRIPS Agreement, by allowing patenting of plant variety and micro-organisms and mutations involving non-biological processes, will prevent the diffusion of advances in the field of biotechnology. India will be hindered by patent to develop an indigenous biotechnology industry using its own germ plasms. With the adoption of the TRIPS Agreement, patenting of life forms themselves is round the corner. The patenting of plant varieties, and of plants and animals essentially using non-biological and micro-biological processes, is the first step in this direction. Since micro-organisms which are patentable are living organisms, their patenting can lead to the patenting of all life forms. In the USA, patenting of micro-organisms and of life forms created by gene manipulation has already become a part of law.

Patenting of Life

In 1971, General Electric and one of its employees, Ananda Mohan Chakrabarty applied to the US Patent Office, for a patent on a genetically engineered Pseudomonas bacteria. Taking plasmids from three kinds of bacteria he transplanted them into the fourth. As he explained 'I simply shuffled genes changing bacteria that already existed'. The Patent Office rejected the application on the basis that animate life forms were not patentable. The case was appealed in the Court of Customs and Patents Appeals Office, and in the Supreme Court nine years later, Chakrabarty was granted his patent on the ground that the micro-organism was not a product of nature but Chakrabarty's invention and, therefore, patentable. As Andrew Kimbrell, a leading US lawyer recounts 'In coming to its precedent shattering decision, the Court seemed unaware that the inventor himself had characterised his 'creation' of the microbe as simply shifting genes, not creating life'. On such slippery grounds the first patent on life was granted and, in spite of exclusion of plants and animals in the US Patent Law, the US has since then rushed on to grant patents on all kinds of life forms. It is this inexorable rush for patenting all life forms that will be extended to our country through the opening provided by the TRIPS Agreement [Shiva, 1994].

The European Patents Treaty prohibits patenting of life but the European Commission, at the instance of industries, has been proposing amendments which would lift the ban. Their attempt received a set-back recently when the European Parliament rejected their move, but the Commission has not abandoned the objective.

Patenting, or effective protection otherwise, of plant varieties will be a disincentive to the kind of innovation that takes place at the farm level in several developing countries. They possess most of the bio-diversity available in the world, they improve plant varieties and preserve bio-diversity. Patenting of plant varieties, genes, genetic material and genetically engineered crops and plants will accelerate the process by which plant and agricultural diversity is eroded. And erosion of bio-diversity poses a serious threat to the environment as well as to development.

The TRIPS Agreement thus is in contradiction with the objective of the Bio-diversity Convention, to 'conserve biological diversity and make sustainable use of its components'. Moreover, there are other contradictions between the TRIPS Agreement on the one hand and the Bio-diversity Convention and other multilateral environmental agreements on the other hand. For example, genetically modified organisms are alien to the ecosystem in which they are released and they, therefore, carry risks to bio-diversity and indeed to the entire environment. Moreover, Article 8 of the Bio-diversity Convention includes, among the obligations to conserve biological diversity, the duty to ensure the *in situ* conservation of plants, crops and animals which may depend heavily on their natural habitat for protection. Patenting of plant varieties and micro-organisms would amount to an assault on the knowledge, innovation and practices of indigenous and local communities whose traditional lifestyles are in keeping with the conservation and sustainable use of biological diversity.

Utilising the Flexibility of the TRIPS Agreement

It will be necessary for member states of the WTO to enact new legislations or bring about necessary adjustments in their existing legislations, to give effect to the TRIPS Agreement. In order to safeguard their development and other interests, the developing countries should take full advantage of the flexibility provided in the TRIPS Agreement in drafting or revising their national legislations. In particular, full advantage should be taken of the provisions in the Agreement regarding exclusions from patentability. The exclusions should include life forms, plants and plant varieties on the plea that they are in the nature of discoveries and not inventions, also on the ground of human health and environment and for protecting public order and morality. National legislations should provide for compulsory licensing on the grounds covered not only in Article 31 on Use Without Authorisation but also in Article 7 (Objectives) and Article 8 (Principles). Article 31 provides that a patent can be used without the authorisation of the patent-holder, by reason of national emergency, in circumstances of extreme urgency, in cases of public non-commercial use, for dealing with anti-competitive practices or for the exploitation of a dependent patent. According to Article 8, member states can adopt measures necessary to protect public health and nutrition, to promote public interest in sectors of vital importance to their socio-economic and technological development, to prevent the abuse of IPRs by right holders and prevent resort to practices which unreasonably restrain trade or adversely affect the international transfer of technology. These provisions would justify compulsory licensing in the sensitive sectors for ensuring adequate supply at reasonable prices of essential goods, like food and medicines, to the public and for facilitating transfer of technology.

The following other suggestions have been put forward for inclusion in national legislations:

(a) Preserve the 'breeder's exception' and 'farmer's privilege'.
(b) Provide for compensation by the title holder to traditional farmers who have supplied genes or knowledge for the development of the protected variety.
(c) Provide for protection of traditional knowledge and innovation of the local and indigenous people.
(d) Specify, in accordance with Article 40(1), 'licensing practices or conditions that may in particular cases constitute an abuse of intellectual property rights having an adverse effect on competition in relevant market'.
(e) Use Article 6 on exhaustion to provide for parallel imports of patented goods.

The developed countries are bound to brand such measures in the national legislation of Member States, as a violation of the patents which are protected in the TRIPS Agreement. They may also be expected to take punitive actions against such violations. This raises the question as to whether a country has the freedom to have an intellectual property regime which is really *sui generis*. The developed countries are also likely to point out that measures permitted under Articles 7 and 8 must be 'consistent with the provisions of this (TRIPS) Agreement', which on the whole are designed mainly to safeguard the commercial interest of the patent-holders and that, so far as compulsory licensing is concerned, the measures to be provided in national legislation on the basis of Articles 7, 8, 27 and 40 must be consistent with Article 31 which lays down draconian conditions for 'use without authorisation'. There is already an example of a developing country, Argentina, having been obliged to rescind or drastically amend a legislation on IPRs which was fully consistent with the provisions of the TRIPS Agreement.

The United States is linking access for developing countries to its Generalised System of Preferences (GSP), to its bilateral aid, to IPR protection, to revamping its patent legislation much before the end of the transitional period, and not to availing itself of all the flexibility provided in the TRIPS Agreement. The best course of action for India will be to prepare a draft legislation using fully the flexibility in the TRIPS Agreement and start a public debate on it in the country right now, even though the legislation may be passed by the Parliament only towards the end of the transition period. For, the most effective way to frustrate outside pressure is to take the Parliament and public into confidence, maintain full transparency about what we are allowed by the TRIPS Agreement to do, and what the Government intends to do and go about enacting the new legislation with full national preparedness rather than being hustled into it under the pressure of foreign governments.

IV. TRADE IN SERVICES

In the 1982 GATT Ministerial Meeting, the United States had argued that one of the objectives of the Meeting should be to establish a work programme on services in GATT so as to prepare a technical basis for multilateral negotiations in this area. The developing countries were completely against the idea of bringing trade in services under the discipline of GATT mainly because, given the incipient stage of development of their service industry, it would not be in their interest to open up this industry to foreign competition, mainly from the transnational corporations of the developed countries which dominate trade in services. Also international trade in services, different from trade in goods, could call for the exercise of the right of establishment which would have implications for the development strategy, resources mobilisation, industrial policy, social objectives, and even, for the cultural identity and the security of the country opening up its market for services. Besides, discussing services in GATT could lead to the establishment of a link between concessions in trade in goods and those in trade in services.

The compromise reached in 1982 was that contracting parties to GATT with interest in trade in services could undertake national studies on trade problems in this sector and exchange relevant information through international organisations such as GATT. The results of such examinations were to be reviewed at the 40th session of the GATT Contracting Parties in 1984, which would also consider whether action on negotiations on services was appropriate and desirable. The 40th session of the Contracting Parties decided to establish a Working Group aimed at improving information regarding services.

At Punta del Este, the developing countries, no longer able to prevent the inclusion of services in the Uruguay Round, tried to safeguard their interest mainly by two devices. At the substantive level, they managed to get included among the objectives of the negotiation, 'development of developing countries'. They also tried to ensure that their commitments in this area were consistent with their development priorities and their national laws and regulations. However, the compromise accepted by developed countries was the clause: 'while giving due respect to national policy objectives'. At the procedural level, the developing countries succeeded in establishing a distinctly separate negotiating process for services from that for goods, to be conducted in an *ad hoc* juridical framework outside GATT. However, firm determination of developed countries to bring services within the scope of GATT was clear from such other provisions in the Punta del Este Declaration as the negotiations in all areas being 'a single undertaking', and the same Trade Negotiating Committee monitoring the negotiations in the areas of both goods and services. The Dunkel Draft Text brought all the agreements resulting from the Uruguay Round of negotiations under the single umbrella of the proposed Multilateral Trade Organisation (MTO) (later WTO), which presented the entire package on a take-it-or-leave-it basis and which proposed a single dispute settlement mechanism for all the agreements.

The GATS basically provides a multilateral framework of principles and rules which should govern trade in services under conditions of transparency and progressive liberalisation. It spells out certain general obligations such as extension of the MFN principle, maintenance of transparency and, also, a commitment for liberalisation in general terms. Specific commitments for liberalisation related to sectors or sub-sectors of services have been left to be negotiated subsequently. However, some guidelines for negotiation in selected key sectors have been laid down.

Article XVI of GATS provides for specific commitment regarding foreign market access. The provisions in this Article are very sweeping. It stipulates that in sectors or sub-sectors where market access commitments are undertaken, a member shall not maintain or adopt:

(i) any limitation on the numbers of services providers;
(ii) any limitation on the total value of services transactions;
(iii) any limitation on the total number of service operations or on the total quantity of service output;
(iv) any limitation on the total number of natural persons that may be employed in a particular service sector;
(v) any measure which restricts or requires specific types of legal entity or joint venture through which a service supplier may provide a service; and
(vi) any limitation on the participation of foreign capital in terms of maximum per cent limit on foreign shareholding or the total value of individual or aggregate foreign investment.

A footnote to Article XVI (1) clarifies that 'If a Member undertakes a market access commitment in relation to the supply of a service .... and if the cross-border movement of capital is an essential part of the service itself, that Member is thereby committed to allow such movement of capital'.

Article XI provides that, except on balance-of-payments grounds, 'a Member shall not apply restrictions on international transfers and payments for current transactions relating to its specific commitments'.

Access commitments of such a sweeping nature will have far-reaching consequences for developing countries. Some of these are:

(a) They will lose their right to control the transfer abroad by foreign firms of resources earned in the form of profits, interest, royalties, etc., and resources needed for carrying out their current transactions.
(b) They will not be able to control equity participation or expansion by foreign firms.
(c) They cannot impose any restrictions on the number of experts that the foreign service provider may decide to bring.
(d) Once they undertake a commitment to liberalise financial services like insurance and banking, no state monopoly will be permitted in these sectors. In the case of India, insurance and banking will have to be denationalised.

Article XVI, of course, has a major qualification and it is conveyed by the phrase 'unless otherwise specified in its schedule'. This means that Member States will be able to specify in their respective schedules of commitment, limitations relating to all the stipulations for liberalisation under Article XVI and its footnote, depending upon the member's bargaining power in the negotiation. Developing countries will be under tremendous pressure to liberalise their service industry and not to specify too many restrictions and limitations in their schedules, or be held responsible for not being serious in the negotiation. And because of their IMF/World Bank-imposed structural adjustment programmes, very few developing countries can afford not to be judged serious in negotiations.

Article XIX of GATS provides that members shall enter into successive rounds of negotiations on services 'with a view to achieving a progressively higher level of liberalisation'. The Article also states that 'there shall be appropriate flexibility for individual developing countries for opening fewer sectors, liberalising fewer types of transactions, progressively extending market access in line with their development situation' and attaching conditions to market access in certain circumstances. But these forms of flexibility are not in the nature of commitment. These are supposed to be kept in mind during the course of the negotiations for undertaking liberalisation commitments in specific sectors or sub-sectors. Whether ultimately the developing countries will be able to exercise any flexibility will depend upon their bargaining position.

The Preamble of GATS expresses the desire of the member states 'to facilitate the increasing participation of developing countries in trade in services and the expansion of their service exports including, inter alia, through the strengthening of their domestic services capacity...'. This is further elaborated in a separate Article under the title 'Increasing participation of developing countries' (Article IV). This Article mentions the measures, such as access to technology and to distributional channels, liberalisation of market access in sectors of export interest to them, etc., for increasing the participation of developing countries in world trade in services.

But here also, there is simply an identification of the necessary measures; there is no commitment to take these measures. Article IV provides that 'the increasing participation of developing countries in world trade in services shall be facilitated through negotiated specific commitments by different parties'. Development of the service industry in developing countries requires transfer of resources and technology. No developed country would undertake such a commitment in a trade negotiation under GATT/WTO, because commitments undertaken in trade negotiations under GATT are of a contractual nature, and not in the form of recommendations, exhortations, norms and guidelines which are the outcome of negotiations in other economic forums like UNCTAD, ECOSOC and the General Assembly of the United Nations.

Article XII of GATS provides for restrictions to safeguard the balance-of-payments position on the lines of Article XVIII:B of GATT. But unlike Article XVIII:B of GATT, Article XII of GATS is available to all members and not only to the developing country members. Besides, there is no provision in GATS corresponding to Articles XVIII:A and XVIII:C of GATT, which permit restrictions for the protection of infant industries. As a matter of fact, paragraph 3 of Article XII of GATS specifically prohibits restrictions 'for the purpose of protecting a particular service sector'. It is ironical that restrictions on protectionist grounds should be available in the field of goods (as Article XVIII:A and XVIII:C are still valid), but should be specifically prohibited in the field of services where the developing countries have made only a beginning and where developed countries have long enjoyed protection.

So far as restrictions on balance-of-payments ground are concerned, these will have to be removed as soon as the balance-of-payments position improves. And recent experience shows that in developing countries, high levels of external indebtedness and payment liability can co-exist with a reasonably satisfactory balance-of-payments position.

The MFN provision of the GATS is not an unconditional one. Article II of the GATS enables Member States to enter exemptions from the MFN clause, i.e., to specify sectors or sub-sectors where they will not extend the most favoured nation treatment.

In fact, in the recently concluded negotiations on services many developed countries have entered MFN exemptions. One of the Ministerial Decisions in Marrakesh provided that MFN exemptions can be entered in relation to financial, basic telecommunications and maritime transport services until the conclusion of the negotiations in these sectors. In their offers, developed countries have entered far more MFN exemptions than developing countries.

The absence of multilaterally agreed criteria governing the conditions on which exemptions can be sought means that exemptions would be claimed not only on the ground of any genuine economic problem but mainly to gain negotiating leverage. This state of affairs has the potentiality of undermining not only the whole process launched through the GATS, i.e., progressive liberalisation of trade in services, but also the entire international trading system.

Because of the domination of transnational corporations in the realm of services, curbing their restrictive business practices becomes very important in the context of liberalisation of trade in services. This problem is recognised in Article IX of GATS but there is no provision in the GATS text in terms of a specific commitment to deal with this problem. The only provision is that 'each Member shall, at the request of any other Member, enter into consultations with a view to eliminating' restrictive business practices, and that 'the Member addressed shall accord full and sympathetic consideration to such a request....'.

This provision is not only totally inane, but could also be interpreted by transnational enterprises as a clear indication that there is no intention on the part of governments to deal with their anti-competitive practices within a multilateral framework. So far as dealing with them through national legislations is concerned, trend is towards obliging developing countries through structural adjustment programmes to eliminate whatever regulation exists for dealing with such practices, rather than legislate fresh regulations to control such practices. Nor is it possible for generally vulnerable developing countries to stipulate in their schedules that their commitment for access in service sectors is conditional upon the service suppliers not engaging in unfair trade practices.

In addition, an elaborate 'Understanding on Commitments in Financial Services' has also been adopted. In general, this Understanding contains more onerous liberalisation obligations than those contained in Part III of GATS on Specific Commitments. The Understanding stipulates that market access and national treatment shall be provided to non-resident suppliers of certain types of financial services like non-life insurance, reinsurance, and provision of financial information, financial data-processing, and advisory and other auxiliary services relating to banking and other financial services. The Understanding also requires Member States to grant permission to foreign service suppliers to offer new financial services in their territories, such as derivatives, futures, options, swaps, etc. By far, the most important provision in the Understanding is that each Member State is expected to grant to the financial service suppliers of any other Member State established in its territory, access to payment and clearing systems operated by public entities, and to official funding and refinancing facilities available in the normal course of ordinary business. Moreover, national treatment is to be accorded to foreign financial service suppliers for membership of, participation in or access to any self-regulating body, securities or future exchange or market clearing agencies and any other organisation or association, access to which is needed for providing financial services on an equal basis.

Developing countries choose not to make commitments specified in the Understanding. However, the fact remains that by acceding to the WTO, the developing countries have become parties to this highly intrusive Understanding on Financial Services, which indicates the future direction in which developing countries will be required to move.

Some of the key provisions on the free movement of labour to seek employment in foreign markets, the only service sector in which the developing countries have decisive competitive advantage are given below:
Annex on Movement of Natural Persons Supplying Services under the Agreement: Paragraph 2: 'The Agreement shall not apply to measures affecting natural persons seeking access to the employment market of a Member, nor shall it apply to measures regarding citizenship, residence or employment on a permanent basis'.

Paragraph 4: 'The Agreement shall not prevent a Member from applying measures to regulate the entry of natural persons into, or their temporary stay in, its territory, including those measures necessary to ensure the orderly movement of natural persons across its borders....' [GATT 1994b].

This Annex of GATS eliminates the possibility of negotiation on labour services except for a very limited category relating to only highly skilled natural persons who move for temporary stay. Hence, the peculiar situation now is that all factors of production except labour can move freely across national borders and that the movement of the labour service depends on the discretionary power of national governments, whereas the movement of other factors of production is governed by some international regime or the other.

In its schedule, the United States has offered to accept only 65,000 persons annually on a worldwide basis covering all professions. Out of this total, the share of India may not exceed a couple of hundreds. In the schedules submitted in the beginning, offers of almost all developed countries were largely limited to (*i*) intra-corporate transfers of managers, other high executives and specialists linked with a commercial presence in the host country, and (*ii*) short-term business visitors who are not gainfully employed in the host country. Few developing countries are in a position to benefit from such an offer. Very few developed countries responded to the key demand of developing countries for commitment for independent professionals to work abroad without the requirement of commercial presence.

The sectors covered by the offers of major developed countries were very wide including most of the areas of interest to developing countries, like tourism, construction and engineering, business services, health-related services, maritime transport, etc. But the professions covered horizontally across these sectors were highly specialised. There were very few offers for contract professionals looking for delivering services in the importing country and none at all for any semi-skilled or unskilled categories like construction workers. Besides, several developed countries in their offers imposed a need test. Some developing countries, particularly India, Egypt, Philippines and Pakistan, tried to establish a link between the negotiations on financial services and those of the movement of natural persons. However, the developed countries rejected any notion of a linkage. In the final offers made on July 28, 1995, some modest improvements were made by developed countries.

Another aspect of labour services, on which the negotiations are supposed to conclude before the end of 1996, is the examination of the discipline, necessary to ensure that measures relating to qualification requirements and procedures, and technical standards and licensing requirements in the field of professional services do not constitute unnecessary barriers to trade. For this purpose, a Working Group on Professional Services was set up at the Marrakesh Meeting and it was asked, as a matter of priority, to elaborate multilateral disciplines in the accountancy sector. The Working Group is yet to be convened. It is not clear as to why India should have agreed to take up the harmonisation of standards in the accountancy sector on a priority basis, when its ability to supply services and competitive advantage would appear to lie in other sectors like managers, medical personnel, teachers, computer specialists, etc.

There are two major points of asymmetry in the treatment of capital and labour services. Firstly, the Annex, by excluding movement of labour for seeking employment abroad and by asserting the supremacy of national immigration and citizenship regimes, has taken out of the purview of liberalisation the bulk of the labour services in which developing countries have competitive advantage. There is no commensurate recognition of the supremacy of national laws and drastic exclusion on that basis, so far as the movement of capital is concerned. Secondly, the Annex, in paragraph 4 permits restrictions, among others, for ensuring the orderly movement of natural persons. There is no similar restriction applicable to the movements of capital, even though capital movements today have become singularly disorderly and volatile.

The schedules of offers made by major developed countries provide very limited access to their markets for the labour services in which developing countries enjoy a competitive advantage. In the areas where greater market liberalisation has been offered, the developing countries lack the capability of taking advantage of it. These countries are, nevertheless, being advised to liberalise their service sector on the ground that liberalisation *per se* will help them by enhancing the competitiveness of their economies, lowering the costs of development through a more rational allocation of resources, and enhancing access to new resources of external finance and technology. This argument on the advantages of liberalisation should apply to developed countries also, in so far as it concerns free movement of labour to their territories from more competitive sources.

In the absence of physical infrastructure, technological capability, human resources development, capacity for resources mobilisation, etc., liberalisation can lead to deindustrialisation by retarding the development of competitive domestic industries and by squeezing out small-scale enterprises. Besides, the liberalisation of the financial services, in the absence of economic stability, may result in the inflow of short-term capital which is very volatile and destabilising and which can trigger capital outflows. Liberalisation of the capital account of the balance-of-payment must await the achievement of the objectives of macro-economic balance and transition to export-led growth [Edwards, 1989].

At the end of the Uruguay Round negotiations, the United States asked for - and got - six months' extension of the negotiations on financial service as it did not find satisfactory the offers made until then. The USA also entered an MFN exemption for this sector as a lever of putting pressure on other trading partners. As a result of this pressure, as of the middle of June 1995, 23 countries had submitted revised and improved offers. A large number of them were from developing countries. According to an estimate of the *Financial Times*, the financial services package on the table at that time covered more than 90 per cent of global banking, insurance and securities business, representing 5 per cent of the world output.

In spite of this, on the penultimate date (29 June), the United States indicated that it regarded the concessions offered by other countries, as inadequate and it would not, therefore, open up its own services market and would file an MFN exemption with WTO for the whole of the financial services sector. On the final day, at the initiative of the European Union, the deadline for the completion of the negotiations was extended until July 28, 1995 before which the WTO Member States were to make up their mind on the options: either to withdraw their offers and provide future access on a reciprocal and discriminatory basis or put their best offers officially in their schedules as a multilateral MFN commitment, for a limited period of 3-5 years after which each of them would be free to review the situation and decide anew. The United States at the end of the four-week extension, would not change its position. Just before the expiry of the extended dateline, some thirty-five countries participating in the negotiation reached an agreement on the liberalisation of financial services on an interim basis after the completion of ratification procedures from July 1, 1996 up to November 1, 1997.

In its final offer, India is reported to have made a few more concessions on financial services, which are not of great consequence. In labour services, the improvements, which Australia and Canada had indicated informally, were formally tabled but other developed countries, particularly US, Japan and EU, did not include any major improvements in their final offers. India's decision to table its final offer and join the consensus, means that it has given up whatever leverage it has in negotiating with the United States for enhanced access for its financial services in the US market. In any event the Government of India should have taken the public into confidence and explained the reasons for the position it took at the final stage of the negotiations on services. Failure of the negotiations on financial services would negatively affect the on-going negotiations on telecommunications and maritime services. The manner in which the United States broke the negotiations and made an easy slide to bilateralism is a major set-back to the new international rule-based trading system enshrined in the WTO.

V. TRADE-RELATED INVESTMENT MEASURES (TRIMs)

The treatment of foreign investment has been a controversial issue for centuries. In the late 18th and 19th centuries, the European imperial powers and the United States were able to extract from foreign governments, treatment for their citizens' or companies' investment which was superior to national treatment or treatment accorded to domestic investors. According to the regime imposed by them, host countries were not permitted to interfere in foreign assets, and seizure and expropriation of such assets were prohibited. These standards diverged from the general principle of international law under which foreigners were subject to local laws and not entitled to standards of justice higher than those applicable to the nationals.

In the post-Second World War period, as a large number of erstwhile colonies emerged as sovereign national entities, there was a trend towards assertion of national sovereignty and curbing of the activities of foreign investors which were regarded as a threat to national sovereignty. Treatment of foreign investment was an important issue discussed at the Havana Conference in 1948. The negotiations that led up to the Havana Charter demonstrated that governments were not prepared to subject their investment policies to international rules and regulations. There was, in fact, much greater emphasis on controlling the restrictive business practices (RRBs) of both national and foreign enterprises. It did not become possible to achieve an international harmonization of rules and regulations designed to control such practices. However, the Havana Charter contained a separate chapter (Chapter V) on restrictive business practices which stipulated in Article 50 that each Member State shall take all possible measures by legislation or otherwise to ensure within its jurisdiction that private and public enterprises do not engage in restrictive business practices. These practices were specified in Article 46 of the Charter.

In the 1950s and early 1960s, the General Assembly of the United Nations in successive sessions adopted resolutions on permanent sovereignty over national resources, which recognised the inalienable rights of all States freely to dispose of their natural wealth and resources according to their national interests. This trend culminated in the adoption of the Charter of Economic Rights and Duties of States in 1974, in the draft Code of Conduct on the Transfer of Technology negotiated in UNCTAD and the draft Code of Conduct for Transnational Corporations negotiated in the United Nations. The Charter of Economic Rights and Duties of States provides that each state has the right to regulate and exercise authority over foreign investment within its national jurisdiction in accordance with its laws and regulations and in conformity with its national objectives and priorities, so that no state shall be compelled to grant preferential treatment to foreign investment. The issues covered by the draft Code of Conduct for Transnational Corporations were: respect for national sovereignty, observance of national laws, adherence to the socio-economic objectives of host countries, appropriation of foreign assets and compensation and regulation of the restrictive business practices of foreign enterprises.

Having reached its peak in the 1970s, the process was once again reversed after the early 1980s when the United States and other major developed countries introduced this subject in the Uruguay Round with a view to:

(a) reversing the past trend of emphasis on permanent sovereignty over national resources and right to nationalisation and expropriation,
(b) reducing what they regarded as unreasonable barriers to the establishment of foreign enterprises in developing countries, and
(c) establishing a regime for a privileged treatment of such enterprises.

While striving for the above broader objectives, the United States set the following specific goals in the negotiations on TRIMs in the Uruguay Round:

(a) Reduce or eliminate trade-distorting barriers to foreign direct investment;
(b) Extend the MFN and national treatment principles to foreign investment;
(c) Identify certain trade-related investment measures (TRIMs) and seek their prohibition;
(d) Introduce greater transparency in such measures through the process of notification, etc;
(e) Subject TRIMs to the dispute settlement procedures of GATT/WTO;
(f) Create a body which will oversee the implementation of provisions on TRIMs; and
(g) Keep this subject under continuing review with a view, ultimately, to establishing a full-fledged regime for the treatment of foreign investment.

Developing countries, on the other hand, wanted investment measures that would oblige foreign investors to observe their national priorities, make foreign investment supportive of transfer of technology and industrialisation, and control anti-competitive and trade-restrictive business practices of foreign investors. Some of the restrictive business practices and associated investment measures to counter them are given below:

Restrictive Business Practices by the TNCs in Developing Countries and TRIMs Designed to Deal with Them

RRBs	Associated TRIMs
Market allocation	Trade-balancing requirement, export requirement
Refusal to deal (boycott)	Manufacturing requirement
Price fixing	Local content requirement; local equity requirement; joint venture with government participation
Collusive tendering	Local content requirement; domestic sales requirement
Exclusive dealing	Export requirement
Differential pricing	Local content requirement; domestic sales requirement
Resale price maintenance	Export requirement; local equity requirement
Tied selling	Domestic sales requirement; licensing and technology transfer requirement
Predatory pricing	Manufacturing requirement
Transfer pricing	Remittance and exchange restrictions; manufacturing requirement; domestic sales requirement

Source: Puri and Brusick, 1989, p. 219.

In view of the developing countries, the focus of discussion should be on the examination of direct significant negative effects on trade of investment measures, and not investment measures *per se*, which were not covered by GATT. Developed countries, on the other hand, argued that effects could not be separated from the cause, i.e. the TRIMs themselves, and, therefore, they called for the elimination of TRIMs themselves.

The agreement on TRIMs identifies five investment measures as inconsistent with the GATT provisions on according national treatment and on general elimination of quantitative restrictions. TRIMs inconsistent with Article III.4 of GATT are as follows:

(a) the purchase or use by an enterprise of products of domestic origin or from any domestic source, whether specified in terms of particular products, in terms of volume or value of products, or in terms of a proportion of volume or value of its local production; or

(b) that an enterprise's purchases or use of imported products be limited to an amount related to the volume of local products that it exports.

TRIMs inconsistent with Article XI.1 of GATT are as follows:

(a) the importation by an enterprise of products used in or related to its local production, generally, or to an amount related to the volume or value of local production that it exports;
(b) the importation by an enterprise of products used in or related to its local production by restricting its access to foreign exchange to an amount related to the foreign exchange inflows attributable to the enterprise; or
(c) the exportation or sale for export by an enterprise of products, whether specified in terms of particular products, in terms of volume or value of products, or in terms of a proportion of volume or value of its local production [GATT, 1994b].

The measures are of an illustrative nature. With the passage of time, more investment measures that may be considered inconsistent with GATT provisions would be identified and required to be eliminated.

According to the TRIMs Agreement, all specific measures in the above five categories being applied by any member will have to be notified within 90 days of the entry into force of the Agreement establishing the WTO, and they will have to be eliminated within two years - within five years by the developing countries and 7 years by the least developed countries. A developing member country shall be free to deviate temporarily from the obligation to eliminate such measures on balance-of-payments grounds. The operation of this discipline shall be reviewed after five years. A Committee on Trade-Related Investment Measures has been set up to monitor the operation and implementation of this Agreement. Article 6 of the Agreement provides for strengthened obligation for maintaining transparency in the administration of TRIMs.

The United States and other major developed countries achieved almost everything they wanted from the negotiations - identification of trade-restrictive TRIMs and their prohibition, possibility of the identification and prohibition of additional TRIMs, expanding the boundary of the GATT provisions on national treatment and elimination of quantitative restrictions to cover investment measures, introducing greater transparency in TRIMs, establishment of a permanent machinery to monitor implementation, subjecting TRIMs to the WTO dispute settlement procedure, and a review of the whole question of the treatment of foreign investment after five years. Developing countries succeeded in only preventing for the time being the establishment of a full-fledged regime on the treatment of foreign investment.

In order to make the Agreement balanced from the point of view of developing countries, provisions for elimination of TRIMs should have been accompanied by international rules for controlling restrictive business practices. There is very little evidence to show that developing countries made even an effort in this direction.

The safeguard provided on balance-of-payments ground does not apply to the two measures declared as inconsistent with Article III:4. They apply only to the last three measures declared as inconsistent with Article XI:1. Due to the new 'Understanding on Balance-of-Payments Provisions', it would not be possible to apply these safeguards once there is an improvement in the host country's balance-of-payments position, and it will be required to eliminate the identified measures, even if there is a justification to maintain them on broader macro-economic and strategic grounds.

Besides, national treatment in GATT is supposed to be extended to imports of goods in the nature of trans-border transactions, and not to the activities and privileges of investors inside a country. Introducing into GATT issues such as national treatment for foreign investors represents a considerable widening of the scope of international jurisdiction over domestic policies. Investment measures have broader macro-economic and strategic objectives, such as exercise of sovereignty over natural resources, creating employment, etc., and not only the trade purpose. Thus the Agreement, on the whole, seriously restricts policy autonomy in an area that has traditionally been viewed as being primarily of domestic concern.

It is true that there is today competition among developing countries to remove restrictions and provide positive incentives for attracting foreign private investment. These go far beyond the restrictions that have been identified in the Agreement on TRIMs and are supposed to be eliminated. However, the eventuality of developing countries wanting to revert to some of these measures in future cannot be ruled out. Attempts are bound to be made by developed countries to extend TRIMs. In fact, Article 9 on review provides for the consideration of the question 'whether the Agreement should be complemented with provisions on investment policy and competition policy'.

VI. AGRICULTURE

In the Final Act, agriculture has, for the first time, been brought under GATT/WTO discipline. Major developed countries started thinking about liberalising agricultural trade only after they had, through protection, achieved self-sufficiency in the production of some of the important agricultural products, after they developed exportable surpluses in these products, after the share of agriculture in GNP had touched a very low level where agriculture is looked upon mainly in trade terms, and after the burden of providing support to farmers had become increasingly intolerable. The developing countries, barring a few exceptions, are hardly in a position to liberalise their agricultural trade and globalise their agricultural economy even though, in so far as they are exporters of agricultural products, they have varying degrees of interest in the liberalisation of agricultural trade in developed countries.

The Agreement on Agriculture does not go as far towards liberalising agricultural trade as the United States and other like-minded countries would have liked, mainly because of the resistance put up by the European Community. The commitments undertaken are:

(a) To reduce domestic support, measured in terms of AMS (Aggregate Measurement of Supports), by 21 per cent;
(b) To reduce barriers to trade (comprising tariff and tariffed non-tariff barriers) by 36 per cent (tariffication means that all border non-tariff barriers will be replaced by tariffs yielding the same level of protection); besides, all agricultural tariff lines will have to be bound;
(c) To reduce export subsidies by 36 per cent of budget outlays and 24 per cent in quantity;
(d) For those countries which decide to convert their non-tariff barriers into equivalent tariffs, to maintain the current level of market access and to grant minimum access through tariff quotas representing four per cent of domestic consumption in the base year in the first year of the implementation period, going up to 8 per cent by end of the period. For an agricultural commodity that is a designated staple food in a developing country, the minimum access opportunity would have to be 1 per cent of consumption in the first year, going up to 2 per cent at the beginning of the fifth year, and further to 4 per cent at the beginning of the tenth year.

A number of special dispensations have been made for the developing countries. These include:

(a) Their commitments to liberalise will be only two-thirds of those undertaken by developed countries;
(b) For them, the implementation period will be 10 years instead of 7 years for developed countries;

(c) They will not be required to reduce domestic support as long as it does not exceed 10 per cent of the total value of production of basic agricultural products, as against the threshold percentage of 5 per cent for developed countries;

(d) A number of items have been excluded for them from the list of domestic support measures, as well as export subsidies, which are subject to reduction. As regards domestic support measures, apart from general exceptions for all countries in such areas as stockholding costs, disaster relief and assistance under regional and environmental programmes, the developing countries may, in addition, claim exemption for subsidies linked to development programmes such as general investment subsidies, input subsidies for low-income producers, etc. As regards export subsidies, the developing countries can get exemption for subsidies on marketing costs, internal transport, etc.;

(e) Least developed among developing countries are exempt from all the commitments under export subsidy, domestic support measures and tariff cuts.

Given the subsistence nature of agriculture in most of the developing countries and their inability to subsidise agriculture on any sizeable scale, these countries will not, for the time being, be required to assume many of the liberalisation obligations provided for in the Agreement. But the fact remains that they have, in principle, agreed to bring their agriculture under a multilateral discipline - something which the developed countries did not do for a good 50 years after GATT came into force. The implications of the decision on the part of developing countries to globalise their agriculture are indeed far-reaching. This step can affect their plans of food security, agricultural self-sufficiency, agricultural exports and prices, crop pattern and even consumption pattern.

Since the domestic support level in India at present is much below the ceiling of 10 per cent. India will not be required for the time being to undertake any commitment for the reduction of domestic support. However, our subsidies in some sectors, like oilseeds and sugar, may well exceed 10 per cent. Besides, if we want to compete in the world market, we may have to increase our subsidies substantially, which may soon cross the limit of 10 per cent. In that event, we will also have to accept commitment for reduction of domestic support.

The Agreement on Agriculture will also require the developing countries to target agricultural input subsidies at 'low-income and resource-poor' producers and food subsidies on the basis of 'clearly-defined criteria related to nutritional objectives'. In India, agricultural input subsidies are available to all farmers, and not only to low income producers. If we want to exclude agricultural input subsidies from the AMS, we will be obliged to provide such subsidies only to low income farmers. Similarly, for exemption from AMS of subsidies on food, we will have to confine access to the public distribution system (PDS) to those who do not meet a minimum nutritional criterion. This implies that we may have to subject our PDS to international surveillance.

The Agreement on Agriculture provides that so long as developing countries are authorised to apply balance-of-payments restrictions under Article XVIII:B of GATT, they will not be required to convert these restrictions into tariffs and undertake the resultant reduction commitment. In that situation, they will also not be required to undertake any minimum access commitment. But this safeguard is not fully reliable. Firstly, thanks to the IMF/WB imposed structural adjustment programmes, not a few of these countries have seen their balance-of-payments position improve at the cost of a growing burden of external debts and stagnant growth. The balance-of-payments cover can be withdrawn from these countries whenever it suits the convenience of the major agricultural trading nations. In that event, developing countries also will have to provide minimum access. Secondly, what the developing countries need is restrictions on protectionist grounds as the developed countries have applied all these years, and not only restrictions on balance-of-payments ground.

India may not also be able to escape for too long the commitment for providing minimum access. Once our balance-of-payments protection is removed - and this may come very soon because of our vastly improved reserve position - we will be required to convert the existing non-tariff restrictions into equivalent tariff values and also simultaneously accept the minimum access commitment. We will then have to import agricultural products, including foodgrains, even if we do not need to do so. This will impair our balance-of-payments position and prevent us from attaining agricultural self-sufficiency which is a very crucial element of national security.

Thanks to the reductions in the domestic support level and in the barriers to trade in the developed countries, there will be an improvement in the prospects of developing countries' agricultural exports to their markets. But the improvement will be very limited, determined by the very modest extent of liberalisation agreed to in the Agreement on Agriculture. An average of some 70 per cent of the present restrictions will still remain intact.

Secondly, the competitive position of the developing countries will improve only in relation to the domestic suppliers in importing developed countries. They will still have to compete with suppliers in other developed and developing countries whose relative competitive position *vis-a-vis* the domestic suppliers, would also have improved. So far as India is concerned, the competitive position of Argentina, Australia and New Zealand will improve in the export of wheat, and that of Thailand and Burma in the export of rice. These countries are lower cost producers of wheat and rice than we are.

Thirdly, any advantages gained by way of price increases in the markets of developed countries due to reduction in domestic subsidies, may be swamped by the disadvantages of exchange rate fluctuations.

Fourthly, the price factor is not the only determinant of exports. Agricultural exports in particular, depend very much on the efficiency and effectiveness of micro-management - that is, the ability to adhere to quality and standards specifications, adherence to the time-schedule for delivery, etc. This in turn, depends upon the infrastructure of trade in developing countries, such as transport, refrigeration facilities, etc., which are generally in a poor state of development.

Fifthly, agricultural exports, being dependent on a gamut of services which many developing countries are unable to provide or can provide in very partial or inefficient way, are becoming increasingly controlled by a few trading companies having a mastery over the different services required for such exports.

The Final Act includes a separate Agreement on Sanitary and Phyto-sanitary Measures which lays down very stringent standards to be followed by potential agricultural exporters. Very few developing countries will be able to meet these standards. One of the more rigorous provisions of this Agreement is that the exporting countries are required to prove that their standards are equivalent to those of the importing countries (Article 14). Further, even in the modest liberalisation commitment undertaken in the Agreement on Agriculture, there is a big loophole in the form of Special Safeguard provisions. These permit the application of additional duties in case of prices below a certain reference level and could reintroduce some of the most restrictive practices of the past, such as the use of variable levies by the then European Community.

The agriculture trade liberalisation will result in an increase in food prices which will adversely affect the food importing developing countries. According to the World Food Programme, virtually all least developed countries are food deficit countries, while a majority of low-income countries are recipients of food aid. The positive effect of the implementation of the Agreement on Agriculture could be that as the size of the present residual free market for agricultural products increases due to liberalisation, the prices in these markets will become less volatile. However, price instability arises mainly because of the speculative behaviour of the actors in the market and not necessarily due to its small size. Speculative transactions could increase as the market becomes less protectionist. A recent FAO study has concluded: 'These simulated results show that the Uruguay Round appears to have very little effect on the stability of cereal market prices' [Greenfield and Konandreas, 1995].

VII. OTHER MAJOR AREAS OF CONCERN TO INDIA

Agreement on Textile and Clothing

The Agreement to integrate trade in textile and clothing into GATT by phasing out the discriminatory and protectionist Multi-Fibre Agreement (MFA) is indeed a gain for developing countries. In the negotiations, the developing countries wanted the dismantling of the restrictions to commence from the very beginning and continue progressively throughout the transition period until it was completed. However, the scheme of phasing out over a ten-year period is back-loaded in that it may involve no liberalistion at all on the date of commencement, only marginal liberalisation at the end of three years, only some liberalisation at the end of seven years, and full liberalisation only at the end of ten years.

The stipulated integration of the MFA into GATT will be in four phases, first on January 1, 1995; the second on January 1, 1998; the third on January 1, 2002; and the fourth on January 1, 2005. The four-phase removal of restrictions will proceed by percentages of the total volume of imports in 1990, 16, 17, 18 and 49 per cent, respectively, and the percentage will apply to all the textile products mentioned in the Annex to the Agreement. The Annex includes many products that have never been restricted under the MFA in any importing country. This will enable the importing countries to meet the integration percentage required under the Agreement with an inflated volume of base imports, and to avoid the liberalisation of the existing MFA restrictions during the earlier stages of the integration. According to the figures of imports in 1990, 37 per cent of the total import of textiles and clothing by the United States was outside MFA restriction, the figure for the then EC being 34 per cent. This means that the USA and EU need not assume any obligation at all to liberalise on the date of entry into force of the WTO. In reality, the first stage of integration of MFA carried out on January, 1, 1995, did not result in any MFA liberalisation in the EU and the USA.

The programme for the subsequent stages of liberalisation published by the United States indicates that very few restrictions will be liberalised at the beginning of the second stage. The extent of cumulative liberalisation to be undertaken at the commencement of the third phase being 16+17+18=51 per cent, the USA and the EU by including in their package of liberalisation all the non-MFA imports, will be liberalising MFA restrictions only to the tune of 14 per cent and 17 per cent, respectively.

At the end of the implementation period of 10 years, i.e., at the beginning of 2005, liberalisation of MFA restrictions to be undertaken by the USA and EU will not be only 49 per cent as is popularly believed, but 86 per cent and 83 per cent, respectively, of their imports under MFA restrictions. Thus, the bulk of the MFA restrictions will remain to be liberalised at the end of the implementation period. Since each importing country will unilaterally select the products to be integrated into GATT, it can be expected that the most sensitive products in which the growth rates are the lowest and quota levels consistently filled, will be left to be liberalised at the final stage.

Going by the experience of the Short-term Textiles Agreement (1960-61), the Long-term Textiles Agreement (1962-73) and MFA (1974-), the insistence during the Uruguay Round of negotiations upon reciprocity by developing countries, and the inability of developing countries to reciprocate, this commitment by the developed countries to liberalise almost three-fourths of imports under MFA restraint at once in 2005 does not sound credible.

If the liberalisation of sensitive items can be postponed till the end of the implementation period, then the importing country will have no incentive to bring about structural adjustments in their textiles and clothing industry before then. It will then become very difficult for the developed countries to liberalise all the sensitive items without having carried out any structural adjustment. The major review to be undertaken at the end of the third phase could become an occasion for a demand for renegotiation.

The provisions of Article 7 of the Agreement establish a direct link between the commitment regarding the integration process and some of the other obligations, e.g., to achieve improved access to markets for textiles and clothing products through the reduction of tariff and non-tariff barriers, and to apply policies relating to fair and equitable trading conditions in such areas as dumping, subsidies and protection of IPRs. Some importing developed countries interpret these provisions as linking the integration process to further tariff concessions by exporting developing countries on their import of textiles from developed countries, and their compliance with other agreements in the Final Act. The developing exporting countries on their part are not, as a matter of principle, prepared to pay for the phasing out of a scheme which is illegal and a derogation from GATT.

While existing MFA restrictions are being phased out, new restrictions of a discriminatory nature, are permitted under the provision on 'transitional safeguards', to be applied to products which are still under MFA restrictions. There is an increasing evidence of the developed countries resorting to these safeguards. Almost simultaneously with the announcement of the integration of unrestricted products on January 1, 1995, the United States called on the exporting countries to exercise voluntary restraints on their exports considered sensitive by the United States, failing which they would be subject to the US quotas. During the short period of the existence of the WTO, the Untied States has initiated 20 actions to institute new quotas. Japan which never used the MFA is now considering the application of transitional safeguards. In terms of market access, almost all the developing countries have made significant reductions of textiles tariffs and several of them have also liberalised their import regime autonomously. Their liberalisation commitments are being fulfilled from the day the WTO was established.

Understanding on Balance-of-Payments Provisions of the GATT 1994

This Understanding is more in the nature of an interpretation and extension of the existing GATT rules than making new rules or establishing a new regime altogether. The understanding critically affects the position of the developing countries, particularly their claim to special and differential treatment. Besides, it has been claimed, rather erroneously, that since the developing countries can go on applying restrictions under Article XVIII of GATT, the obligations that they are assuming under some of the new regimes established under the WTO, are not at all as onerous as they are made out to be. Article XVIII of the GATT is entitled: 'Government Assistance to Economic Development'. This Article recognises a category of countries 'the economies of which can only support a low standard of living and are in the early stages of development' and extends special dispensations to them. This category of countries, synonymous with developing countries, can, according to this Article, deviate temporarily from the other Articles of GATT and withdraw or modify concessions or otherwise adopt restrictive measures, as a means of government assistance for economic development.

Article XVIII of GATT had come to be regarded by developed countries as providing for 'free riding' by the developing country members of GATT. To bring this 'free riding' to an end, 'Understanding on Balance-of-Payments Provisions' put the developing countries on par with all other members of the WTO, so far as the imposition of restrictions on the balance-of-payments ground is concerned. By adopting the text, the developing countries are now committed to giving preference to price-based measures such as import surcharge, import deposit requirement, etc., and imposing quantitative restrictions only when price-based measures cannot arrest a sharp deterioration in their external payments position. Every restriction will have to be notified, explanation will have to be given as to why price measures could not be adopted and a time schedule will have to be fixed for the removal of restrictive import measures taken for balance-of-payments purposes.

The developing countries had not assumed such explicit obligations either under Article XII or XVIII:B of GATT. Moreover, the entire Article XVIII is on 'Governmental Assistance to Economic Development'. The Understanding on Balance-of-Payments Provisions makes no reference to the problem of development and contains no differential or special provisions for developing countries. The text of the 'Understanding' also contains no provisions equivalent to Article XVIII:A and XVIII:C of GATT which enable the developing countries to maintain or apply import restrictions for the purpose of protecting their infant industries. It is significant also that GATS has no similar provision. According to Article XII of GATS, member countries need not offer any liberalisation commitments in their schedules in sectors or sub-sectors which in their view require to be protected. They are also free not to offer any bindings in these, and are free to adopt fresh restrictions for protecting their service industries. But this is only a technical position. Whether they will be able to do so in practice will depend upon their clout as trading nations and their consequential bargaining power. So far as trade in goods is concerned, the technical position is that the whole of Article XVIII is still valid. But in reality, with the adoption of the 'Understanding', the days of 'free riding' for the purpose of applying import restrictions as a form of governmental Assistance to Economic Development, are over. Thus, the relief or reprieve that the developing countries can claim on the balance-of-payments ground, in the application of the new regimes under the WTO, is of a very limited character.

VIII. SECURITY AND PREDICTABILITY

The WTO apparently enhanced security and predictability of the international trading system. The agreements singled out in this regard are those on Dispute Settlement, Safeguards, Anti-Dumping and Countervailing Duties, and Subsidies.

Understanding on the Rules and Procedures Governing the Settlement of Disputes

The Dispute Settlement Body (DSB) of the WTO is claimed to be the central element providing security and predictability to the multilateral trading system. In the GATT provisions there was considerable scope for procedural delays. Also the offended party could apply sanctions without the specific permission of the Contracting Parties. In the dispute settlement mechanism of the WTO all Member States have undertaken a commitment to eschew unilateral action and instead use the DSB. A faster and definitive time-table has been laid down for dispute settlement so that the entire process may be completed within 12-15 months. Neither the Panel Report nor the verdict of the Appellate Review Body can be rejected except by consensus. Concessions cannot be suspended without the authorization of the Dispute Settlement Body. Similarly cross-retaliation is allowed only as the third stage in a three-step procedure.

In spite of these elements of certainty and predictability, there are several weaknesses in the WTO dispute settlement mechanism. Firstly, the enforcement of any dispute settlement action will depend entirely upon the complaining country's willingness and ability to take action on its own. If it is not a major trading partner of its opponent, its action will be of no avail. This has been very effectively, rather blatantly, brought out in an editorial of the *New York Times* of 23 July, 1994. The editorial says: The United States has so much leverage that it has little to fear from retaliation; in fact, the WTO would not change the dynamics of trade for any strong industrialised nation. Currently, the United States can block any unfavourable rulings and, while complaining countries can still retaliate, they rarely do so out of fear of triggering a self-destructive trade war. The same fear will govern retaliation under the World

Trade Organisation even though the United States cannot resort to the legal necessity of blocking unfavourable rulings.

Throughout the negotiations and following the establishment of the WTO, the United States has insisted that nothing in the WTO requires it to give up taking recourse to Section 301 of its Trade Act. In fact, Japan, the EU, India and Pakistan have been threatened by action under 301 since the establishment of the WTO. The French Government has proposed that the EU adopt a provision equivalent of 301. The consequences will be that, in spite of the WTO's DSB, no country will feel secure against a strong trading partner which decides to act as a bully. The ultimate sanction in the new dispute settlement mechanism remains the same as in the GATT, i.e., denial of market access. This is hardly an effective instrument for a country, with a small market or under various kinds of pressure, to use. It is suggested that the Understanding on Dispute Settlement needs to be amended to incorporate a provision on collective sanction. However, the dominant trading powers would never agree to such an amendment and no amendment to the Understanding on Dispute Settlement can be made without their approval. The only area in which collective sanction can be applied, is breach of or threat to peace, under Chapter VII of the UN Charter. Here too, the major political powers have brought immunity by virtue of their veto power as the Permanent Members of the Security Council. They have given themselves a veto in the WTO also by providing that amendments to the Understanding on Dispute Settlement can be made only by consensus.

The dispute settlement mechanism of the WTO was diluted right in the beginning when the USA added a rider stating that decisions of the DSB involving the United States could be reviewed by US judges, who would report to the Congress. If within five years they found three decisions to be unjust, the Congress could authorise unilateral action by the United States or even recommend that the USA withdraw from the WTO.

Agreement on Safeguards

Safeguards against serious injury to domestic industry due to a sudden spurt in the imports of a particular product were originally provided for in Article XIX of GATT. Under this Article, a Contracting Party is allowed to impose restrictions or withdraw concessions in order to remedy the situation. However, such safeguard measures must be applied on a non-discriminatory basis and only after it has been demonstrated that a serious injury has been or is threatened to be caused to the domestic industry. There are also provisions for international surveillance of such measures and for the affected Contracting Party, after due process of consultation, to demand compensation or failing that, to take retaliatory action by withdrawing, suspending or altering concessions.

Over the years, the major trading powers resorted to restrictive measures outside GATT, on the basis of voluntary agreements, often imposed through pressure. The Multi-Fibre Agreement was the quintessential example of such measures. Other measures which came to be known as 'grey area measures' included voluntary export restriction, orderly marketing arrangements, price monitoring system, etc. These measures are clearly illegal, as they are taken outside GATT. Nor do they conform to the basic provisions of Article XIX as they are discriminatory in nature, they are bilateral and, hence, beyond international surveillance and they do not provide for compensation or retaliation.

The great majority of these measures were taken by major developed countries against the exports of developing countries. As of April 1988, 191 restrictive arrangements were in force covering such products as automobiles, transport equipment, steel and steel products, electronics, temperate zone agricultural products, textiles outside MFA, footwear, machine tools, etc. Nearly 80 per cent of these actions were taken by EC, USA and Canada. According to UNCTAD statistics, developed countries subjected some 8 per cent of their total imports (excluding fuels) from developing countries and countries in transition, to grey area measures.

The Agreement on Safeguards in the Final Act prohibits grey area actions and provides for the phasing out of the existing ones within four years, to be extendable for another four years in exceptional circumstances. It subjects future safeguard measures to certain strict procedures like investigation by the importing country which will include reasonable public notice to all interested parties, publication of the report of the investigation, etc. Future safeguard measures will be applied generally on an MFN basis. And no safeguard action will be taken against a developing country which claims not more than 3 per cent of the total import of the product being subjected to such action (Details of *de minimis* provisions in the Agreements on Safeguards. Anti-Dumping Measures and Subsidies are given in Appendix I).

In spite of these improvements, the Agreement on Safeguards permits flexibility to the importer to allocate its global quota among exporters in proportion to the extent of injury caused by them. This departure from MFN is permitted in cases where imports of a product from certain members have increased disproportionately in relation to the total increase in imports in a representative period. The Agreement lays down that reasons for such a departure should be given and consultations should be carried out in advance. Yet, it is a reversal back to selective safeguards.

Another weakness of this Agreement is that it does not apply to trade in textiles, to GATS and to trade in agriculture. The special safeguard measure provided in the Agreement on Textiles and Clothing maintains the discriminatory element of the MFA for the products which remain to be integrated into GATT. Finally, the special exemption given to a developing country exporting less than 3 per cent of the total imports is diluted by the provision that no such exemption will be given if collectively these minor suppliers account for 9 per cent or more of the total imports.

Anti-Dumping Measures and Countervailing Duties

Anti-Dumping measures constitute a pernicious form of protectionism, particularly against the developing countries. The entire justification for such measures is the price differential. But the price differential may be due to natural factors relating to the structure and stage of development of an economy and may not be attributable at all to unfair pricing practices. Besides, the items that enter into variable costs may differ from one economic system to another. Moreover, anti-dumping measures are directed against imports at low prices, and the developing countries are mostly regarded as the low cost countries. They became a favoured protectionist tool in the 1980s for the USA, EU and Australia, and developing countries were the principal targets. They were the subject of 40 per cent of the investigation carried out during the period of the Uruguay Round of negotiations.

The very initiation of the anti-dumping action, irrespective of the outcome of the investigation, inflicts damage on the exports. Provisional duties can be introduced quickly. Even if the final finding is that there is no dumping, harm would have already been done to the exporter. After a negative finding on the allegation of dumping, the duties levied provisionally are refunded, but there is no compensation for lost trade. And the continuation of the anti-dumping investigation quite often degenerates into 'voluntary export restrictions'. Anti-dumping measures, therefore, ought not be a part of any fair and liberal trading system. One of the most desirable outcomes of the Uruguay Round of negotiations would have been, instead of anti-dumping action, inclusion of unfair pricing practices of exporters.

The text (Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade, 1994) lays down more transparent and detailed norms with regard to all the three stages of the anti-dumping procedures, i.e., the establishment of the existence of dumping, demonstration of injury caused by dumping, and the causal relationship between the two. The text also has *de minimis* provision according to which anti-dumping proceedings will be terminated if dumping price margins do not exceed 2 per cent or if dumped imports constitute less than 3 per cent of the total import of the product. However, there are many features in the text on this subject which will make anti-dumping action easier to resort to, for protective purposes.

Firstly, the text retains the use of constructed value in price comparison and in the calculation of dumping margins. This lends itself to continued protectionist abuse of anti-dumping measures. Secondly the new procedures still allow the use of arbitrary profit levels, and do not require a minimum period for the allocation of start-up costs. Thirdly, the new text introduces the concept of cumulative effect on the domestic industry and permits a country to take action, without further investigation, against parts sent for the assembly of an item already subject to countervailing duty. Fourthly, the text provides for the possibility of one country asking another to start anti-dumping procedures on imports from a third country on the ground that these are damaging its own exports. Fifthly, this is going to be the only agreement to be administered by the WTO to which the common dispute settlement procedure will not apply. A last minute modification introduced by the United States does not grant authority to the WTO Panels to challenge the substance of a national investigation [Agosin, *et al.*, 1995, p. 30]. Therefore, the new anti-dumping regulations will remain subject to discretionary interpretation in national laws. *De minimis* provisions are not of much value because they are set at extremely low levels, are close to the existing practices of the users of anti-dumping measures, and are expressed in terms of percentages of total imports and not total consumption.

Since the new text is lawyer-intensive, the developing countries would not have the capability to contest the anti-dumping procedures which will remain a rich country's trade remedy. Many analysts believe that as MFA is phased out, the new anti-dumping procedures may become the most convenient device to restrict the imports of textiles and clothings [Agosin, *et al.*, 1995; Weston, 1995a]. Whereas in the pre-WTO period they still formed part of a voluntary code to which very few developing countries had acceded, in the WTO they are part of the package which all Member States must accept.

Agreement on Subsidies

Agreement on subsidies is another area in which the developing countries have emerged worse off from the Uruguay Round. No doubt, there are some elements of clarity introduced in classifying subsidies in three categories - prohibited, actionable and non-actionable - in defining the actionable subsidies in quantitative terms, and in laying down more stringent norms for imposing countervailing duties. Another redeeming feature from the point of view of India is a provision enabling countries with a per capita GNP below $ 1,000 to continue to subsidise. But these procedural improvements and this temporary exception to a group of countries is totally neutralised by the qualitative changes effected by the Agreement, in the pre-WTO system of export subsidies. In the old system, the developing countries were free to subsidise their exports. The only limitation was the resources that they could muster for this purpose. Several of these countries used subsidies as an important component of their strategy for export-led growth.

The Agreement on Subsidies dramatically changes the whole situation in two important respects. Firstly, it categorically prohibits direct subsidies on exports and those on the use of inputs for production of goods for exports. Further, it makes actionable or subject to countervailing measures, non-trade subsidies which are not for development and other general purposes, but which are specific to certain enterprises or industries and which have an effect on export prices. All existing prohibited subsidies must be phased out within 5 years. The low-income countries are required to eliminate their subsidies within 8 years after they achieve a position of export competitiveness. Thus the developing countries adopting an outward-oriented industrialisation strategy will not be able to resort to subsidies, as applied by such successful economies as Japan, Republic of Korea, Taiwan, etc. Most of the developing countries are already being forced under the structural adjustment programmes to phase out their subsidies; but the Agreement on Subsidies would further limit their option. This will become a classic case of cross-conditionalities as the WTO will be utilised to reinforce the Fund/Bank conditionality to eliminate subsidies. Finally, whereas the Tokyo Round Subsidy Code was applicable only to the signatories, the Uruguay Round Agreement is applicable to all Member States of the WTO.

IX. THE WORLD TRADE ORGANISATION

Towards the end of the Uruguay Round of negotiations, came the proposal for the establishment of a comprehensive over-arching organisation to administer all the agreements reached during the negotiations. Neither Punta del Este Declaration nor the 1988-89 Mid-Term Review Agreement foresaw that the results of the Uruguay Round would be implemented through the establishment of a new organisation. The proposal had been mooted in 1990 by the European Community and, separately, by Canada and supported by other major industrialised countries. The developing countries had been generally opposed to the idea of establishing a comprehensive trade organisation within the framework of GATT because their objective had been to work towards converting UNCTAD into an international Trade Organisation of the kind envisaged in the Havana Charter.

Towards the closing stages of the negotiations, when the developing countries had yielded on most of the substantive issues and when they had become even more vulnerable than they were in the early 1980s, the idea of a comprehensive international trade organisation within the GATT framework was sprung upon them. And here also, as in the substantive negotiations, all the shots were called by developed countries and the developing countries bent their efforts mainly at minimising the damage.

The Draft Final Act proposed by the then Director General of GATT, Arthur Dunkel, included as its integral part, the text of an Agreement Establishing a Multilateral Trade Organisation (MTO). It remained so until the Final Act was approved by representatives of governments in December, 1993. However, at the instance of the USA, the MTO was changed into WTO before the Marrakesh Meeting. The USA apparently thought that the nomenclature could override the substantive content of treaty and that a World Trade Organisation (WTO) would permit the US Congress and Administration greater leeway in international trade policy than a Multilateral Trade Organisation (MTO) could do. The organisational structure of the WTO is shown in Chart 1.

The purpose of the WTO is spelled out in the Preamble and Article II of the Agreement Establishing the WTO. Paragraph 1 of Article II reads: The WTO shall provide the common institutional framework for the conduct of trade relations among its members in matters related to the agreements and associated legal instruments included in the Annexes to this Agreement.

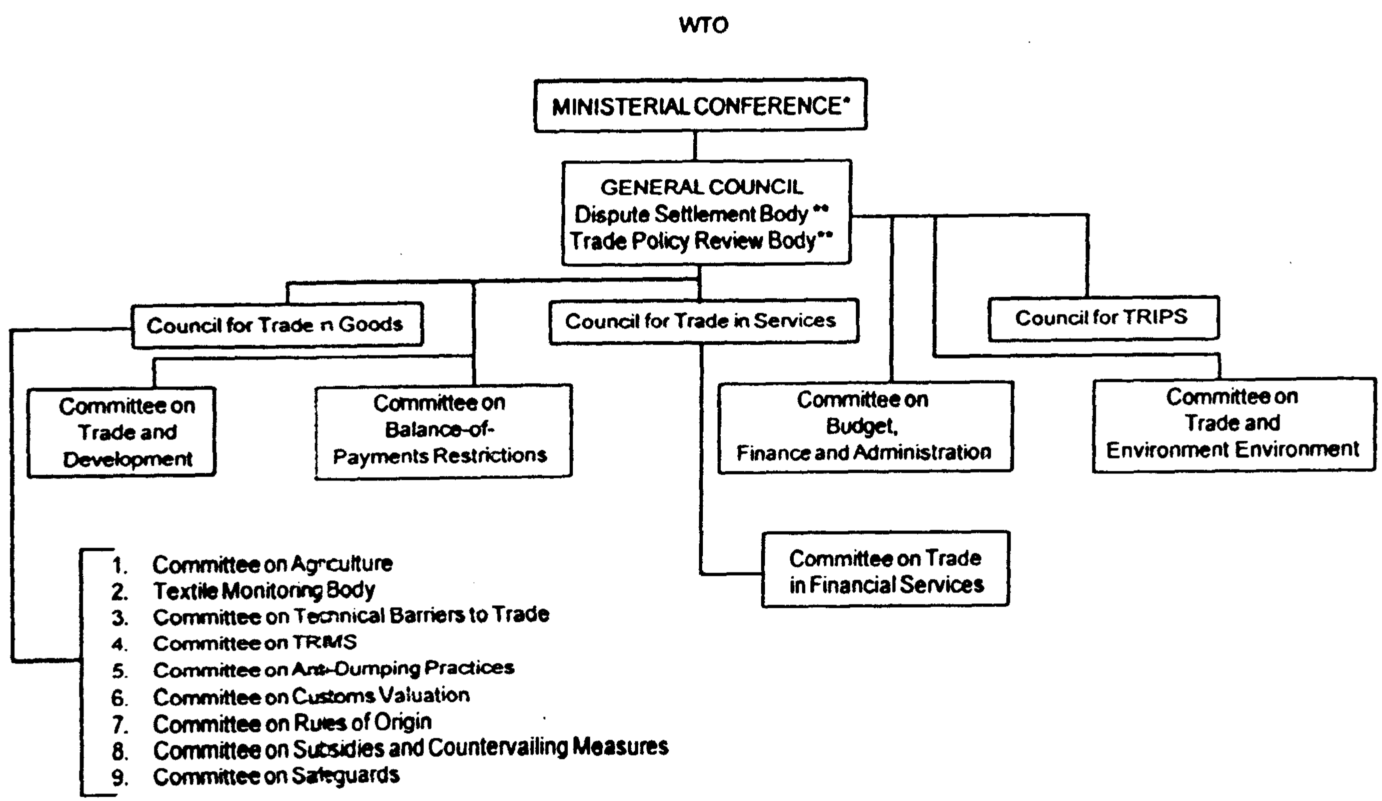
Article III defines the functions of the WTO which include the implementation, administration and operation of all the multilateral trade agreements included in the Final Act, as well as the administration of the Rules and Procedures governing the Settlement of Disputes and of the Trade Policy Review Mechanism.

The GATT Secretariat was set up as an interim arrangement pending the establishment of the ITO provided for in the Havana Charter. Since the ITO never came into being, GATT remained an interim arrangement and was not recognised as a properly constituted international organisation. One of the purposes of the WTO is, therefore, to provide the long-awaited institutional abode for GATT. For several developed countries, it must also have been designed to pre-empt UNCTAD from developing into an ITO or pre-empt the establishment of ITO *per se* for keeping the international trade regime firmly under the control of the major industrialised countries and keeping it within an institutional framework in which these countries can effectively retaliate.

The WTO will administer the Understanding on Dispute Settlement which provides for cross-retaliation. Article 22(3) of the Understanding lays down that 'the general principle is that the complaining party should first seek to suspend concessions in the same sector ....'; and if it considers that 'it is not practicable or effective' to do so then 'it may seek to suspend concessions .... in other sectors under the same agreement'; and if that is also 'not practicable or effective it can suspend concessions... under another covered agreement'.

The flexibility provided for cross-retaliation can be deemed to be almost a priori exhausted. Taking for example the area of services, since developing countries will find it extremely difficult to enter the services markets of the

Organisation Structure of WTO



* The Ministerial Conference and all other bodies except the Textile Monitoring Body consist of the entire membership of the WTO The membership of some of these bodies is by self-selection. The Textile Monitoring Body consists of its Chairperson and 10 other members of WTO.

** The General Council itself will meet as the Dispute Settlement Body and the Trade Policy Review Body.

developed countries, the latter will not be able to retaliate in the services sector against non-compliance of the obligations of developing countries in that sector. Similarly, the developed countries cannot retaliate against the developing countries in the area of TRIPS because the latter have taken out very few patents. So the entire burden of retaliation for acts of non-compliance by developing countries in the services and TRIPS sectors will fall on their exports of goods to developed countries. Through its provision on cross-retaliation, the WTO in a sense legitimises and universalises Section 301 of the US Trade and Competitiveness Act which also provides for cross-retaliation. The United States will still be able to apply 301 in the trade fields not covered by the WTO, in economic fields other than trade, and in non-economic fields.

The developing countries should not be under any illusion that they can also use the cross-retaliation provision of the WTO. Because of the lower stage of their economic growth, with its associated need to import from developed countries in order to keep up the tempo of economic growth, and also due to their weak bargaining position, the developing countries were seldom able to retaliate under Article XXIII of GATT. It is indeed a wishful thinking to believe that they would now be able to retaliate simply because there are now alternative sectors of retaliation.

Another important purpose of the WTO seems to be to compel all Member States to accept each one of the agreements negotiated under the Uruguay Round. Either a country accepts without reservations all the instruments covered by the WTO or is condemned to remain outside the international trading system. It appears that if a country does not become a member of the WTO, it will lose its membership of the GATT, because the GATT, as amended before the entry into force of the WTO and as supplemented by various Understandings reached during the Uruguay Round negotiations, is now a part of the WTO.

Another purpose of WTO is to give enhanced visibility and stature to the international trading system, by strengthening its legal basis through greater transparency, more clear-cut obligations and better enforceability, and by raising the formal status of the organisation through biennial Ministerial Conferences. Another step taken in this direction is to make the new organisation more overtly a part of the dominant international economic policy system consisting of the World Bank and the IMF.

Significant changes have also been made in the minimum voting requirements for taking decisions on major issues. As was the case with GATT, the WTO will continue the practice of decision-making by consensus. However, where a decision cannot be arrived at by consensus, the matter at issue will be decided by voting on the basis of one-member-one-vote principle. Decisions of the Ministerial Conference and the General Council will be taken by a majority of the votes cast. However, on very important matters, much larger majorities will be required for taking decisions. For example, for decisions on an interpretation of a WTO provision and on granting waivers, a three-fourths majority of the entire membership will be required. There are three issues on which decisions will have to be taken by consensus. These are: amendments to the MFN clause in any agreement; amendment to the Understanding on Rules and Procedures Governing the Settlement of Disputes; and on the rejection of a panel Report or of the ruling of an Appellate Body. Decisions on other amendments or on a country's accession to the WTO will be taken by a two-thirds majority of the Members (and not those present and voting).

The WTO will deprive the GATT Contracting Parties of their basic right under GATT of non-discriminatory access for their exports of goods in other member countries' markets. According to Article XXX of GATT, the basic provision of GATT under Article I cannot be amended without unanimity. But with the entry into force of the WTO, Article I will stand amended, because its enjoyment will become conditional upon a Contracting Party accepting new obligations in the fields of Services, TRIPS, TRIMs, etc. The provision of cross-retaliation under WTO is the specific measure through which the dilution of a Contracting Party's rights under Article I will take place.

The Agreement on the WTO provides that new agreements imposing fresh obligations on members can be incorporated by a decision by a two-thirds majority. Any member refusing to accept such a decision can be expelled by a three-fourths majority. The inability of a Member State to bring its domestic legislation in conformity with the relevant WTO agreements can also result in its expulsion by a two-thirds majority. Thus, a member can be deprived of its rights under Article I of GATT for its failure to comply with the provisions of any agreement covered by the WTO or with any fresh agreement under the WTO.

One of the functions of the WTO, as defined in Article III (5), is: 'With a view to achieving greater coherence of global economic policy-making, the WTO shall co-operate, as appropriate, with the International Monetary Fund and with the International Bank for Reconstruction and Development and its affiliated agencies'. The term 'achieving greater coherence in global economic policy-making' has been elaborated in a Declaration adopted on this subject at the Marrakesh Meeting. The Declaration describes how 'the positive outcome of the Uruguay Round' itself constitutes a 'major contribution towards more coherent and complementary international economic policies'. It underlines the need on the part of the international institutions concerned 'to follow consistent and mutually supportive policies'. Finally, it invites the Director-General of the WTO to review with the Managing Director of the IMF and the President of the World Bank, 'the implications of the WTO's responsibility for its co-operation with the Bretton Woods institutions, as well as the forms such co-operation might take, with a view to achieving greater coherence in global economic policy-making'.

The decision of the WTO to single out the IMF and the Bank for co-operation in ensuring coherence of global economic policy-making appears to be a move towards collaborating with these institutions for applying cross-conditionalities in the areas of money, finance and trade. While the Marrakesh Declaration emphasises the need to avoid 'the imposition on governments of cross-conditionality or additional conditions', given the present policies of the Fund and the Bank and those of the major industrialised countries, it is difficult to visualise how the WTO can collaborate with the Bretton Woods Institutions in ensuring coherence in global economic policy-making without getting involved in their conditionalities which are becoming increasingly more rigid and assuming new forms. There is a real danger that the financial power of the Bretton Woods institutions and the stronger bargaining power of the developed countries will be utilised to enforce mainly on the developing countries the rules of the WTO, while leaving the stronger trading powers wide latitude to apply restrictive trade measures.

Article III (2) of the Agreement establishing the WTO reads: 'The WTO may also provide a forum for further negotiations among the members concerning their multilateral trade relations, and a framework for the implementation of the results of such negotiations ...'. The major economic powers intend to use WTO as a forum of perpetual negotiation rather than keep relying on periodic rounds of negotiations, for addressing issues related to each other's internal policy, and other domestic regulatory policies as well as environment protection and labour standards. Even an agenda for continuing negotiation has been laid down. Future negotiations are going to be concerned more with harmonising standards to bring them to the levels of those prevailing in or desired by developed countries and with establishing new regimes, than for horse-trading for the purpose of wresting trade concessions.

Relations with the United Nations

The intention of those who have been instrumental in setting up the WTO is to snap even those links which existed between the United Nations and GATT. GATT was the outcome of the Havana Conference which was summoned under a decision of the Economic and Social Council. The GATT Secretariat came into being in terms of the mandate of the Interim Committee for the International Trade Organisation (ICITO) which was set up by the United Nations in 1948 pending the establishment of the ITO. The first meeting of the GATT Contracting Parties was convened by the Secretary-General of the United Nations, as provided for in Article XXV (2) of GATT. No formal agreement was ever concluded between the United Nations and GATT, the latter being an interim arrangement and not a full-fledged international organisation. For all intents and purposes, GATT functioned as an independent international organisation outside the UN system.

But the WTO has decided to cut even the vestigial umbilical cord that existed between GATT and the United Nations. The WTO Agreement will be deposited with the Director General of WTO and not with the Secretary-General of the United Nations, as was the case with GATT. The WTO has been entrusted with the task of co-operating with the IMF and the World Bank 'with a view to achieving greater coherence in global economic policy-making'. According to the UN Charter, it is the UN's responsibility to formulate global macro-economic policies and strategies which the specialised agencies, including the WTO, IMF and World Bank, should follow. They should also regularly report to the UN and agree to their own activities and policies being co-ordinated by the UN. In the WTO Agreement, there is not even a separate mention of the UN which is grouped among 'other international organisations'.

Subsequent developments indicate that major economic powers, Members of the WTO, are not interested in bringing the WTO within the UN system. Links of across-the-board co-operation have already been forged with the Fund and the Bank. But so far as the UN is concerned, the WTO has only made arrangements with individual agencies and the UN bodies like the WIPO, ILO, ITU, UNCTAD and ITC for consultations and for assistance in helping Member States, particularly the developing ones, in their transition to the new WTO rules and regimes.

Article 57 of the UN Charter makes it obligatory for organisations like the WTO to be brought into relationship with the United Nations. Article 58 of the UN Charter provides that the UN 'shall make recommendations for the co-ordination of the policies and activities of the specialised agencies'. The WTO is a specialised agency as defined in Article 57. Hence, it is incumbent upon the UN to bring the WTO into relationship with the United Nations and make recommendations for the co-ordination of its policies. However, the United Nations is nothing but the totality of nations constituting the membership of the United Nations. And the same nations more or less happen to constitute the membership of the WTO also. It is up to these members to uphold the Charter and compel the WTO to become one of the specialised agencies of the United Nations and to accept such obligations as may be imposed upon it by the United Nations in terms of Article 58 of the Charter.

Relations with UNCTAD

The UNCTAD was conceived as an approximation to the ITO. At the first session of the UNCTAD in 1964, the developing countries wanted to establish an ITO. But as there was no consensus, they were reconciled to establishing UNCTAD as a body of the United Nations and decided to work through the UNCTAD for the eventual establishment of an ITO. This ultimate institutional goal is reflected in the General Assembly resolution (number) 1995 (XIX) establishing the UNCTAD. The mandate of UNCTAD covered many of the subjects which were dealt with in the Havana Charter and which would have come within the scope of ITO. These included the problem of commodities, development, restrictive business practices, etc. However, UNCTAD was not created as a specialised agency as the ITO was intended to be; UNCTAD functioned under the authority of the General Assembly.

Like GATT, the WTO is also no ITO, and given its mandate and the present thinking on international economic co-operation, it is unlikely to become one. The major developed countries are simply not prepared to give to any international organisation an interventionist mandate such as was implicit in the Havana Charter. Besides, the developed countries can be expected to bring only those issues to the WTO on which it is possible to establish rule-based regimes offering possibilities of retaliatory action. Many of the subjects that were included within the objectives and functions of ITO and have been dealt with by UNCTAD, do not lend themselves to such a treatment. Examples are development strategies, the problem of poverty alleviation, commodities, resources transfer, debt, technology, etc. In these areas nations can accept only moral commitments in the interest of human solidarity, and guidelines and norms for the conduct of their policies. It is not possible to bind the developed countries with contractual obligations in these areas, with the possibility of retaliatory action to enforce compliance.

There has been a systematic and concerted effort by major developed countries on the one hand, to downsize the more democratic bodies like UNCTAD, the Economic and Social Council and the UN General Assembly and, on the other hand, to strengthen and further build up the role and functions of organisations like the IMF and World Bank, where decisions are taken on the basis of weighted voting, and GATT/WTO, where major industrialised nations can use their economic muscle to retaliate and cross-retaliate. This evolution appears to be a part of a grand design to perpetuate the stranglehold of these nations over international global economic power structure, particularly on the international trading, financial and monetary systems. They intend to use the instrumentality of WTO and the other means they have devised recently, to achieve this purpose. These include: various conditionalities for providing aid and giving trade concessions; pursuing the objective of non-proliferation of weapons of mass destruction on a discriminatory basis; establishment of *ad hoc* discriminatory regimes for controlling the transfer of dual-purpose technology, equipment and material; and increasing interventions in the domestic affairs of developing countries on the so-called humanitarian grounds.

X. NEW ISSUES FOR NEGOTIATION

The inclusion in the Uruguay Round negotiations of new issues, which are trade-related in a very tenuous way, has opened the way for similar other new issues to be brought on the agenda of the WTO. Among them, the three which are most important and of immediate concern to the developing countries are: trade and environment, trade and labour standards or the 'social clauses', and competition policy.

As regards competition policy, the basic rationale of trade liberalisation is the encouragement of competition. Following the reduction or removal of governmental trade barriers, the logical step forward in the progressive liberalisation of international trade will be to dismantle the private barriers to markets, mainly the barriers created by the transnational corporations, who persistently - and almost as a matter of policy - violate norms of competition. There are examples of foreign patent-holders having abused their monopoly power to penetrate foreign market and to indulge in over-pricing and transfer pricing, and having raised barriers to the entry of competing firms. There is now a more frequent resort than before to restrictive business practices and to cartels and collusions on a global scale, because of the current gaps in the national and international anti-trust laws and the absence of an international regime on this subject.

The fact that several of the practices of business enterprises constitute barriers to trade has been recognised and provisions made on how to deal with them, in the GATS and the Agreement on TRIPS. However, these provisions are mainly in the nature of granting flexibility to governments to restrict such practices in their national laws and calling upon governments to respond to requests for consultations. There are no provisions in terms of specific obligations imposed on Member governments. On the whole, Uruguay Round Agreements address competition issues in a piecemeal and ineffective manner. Besides, they do not deal with such anti-competition practices as export cartels, market exclusion, etc. They do not provide for any mechanism at the global level to monitor restrictive business practices affecting competition, let alone establishing an international regime to deal with them.

There is a long history, beginning from the Havana Charter, of the international community's effort to evolve an international regime to deal with restrictive business practices. A Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices was negotiated in the UNCTAD and adopted unanimously by the UN General Assembly in 1980 (Resolution 35/63). The resolution provided for the creation of an UNCTAD Inter-Governmental Expert Group on Restrictive Business Practices. The Set is not legally binding, but it was expected to be a stepping stone to the elaboration of a legally binding instrument on competition linked to the rules of the international trading system. However, the process of moving towards legally-binding instrument, the UNCTAD Draft Code of Conduct on Transfer of Technology and the UN Draft Code of Conduct for Transnational Corporations, have got derailed.

In the Uruguay Round negotiations, the developing countries should not have accepted the extension of international trade laws to investment measures without extending the laws of competition to investment. Similarly, in the negotiation on GATS, they should have insisted that developed countries should take all possible measures, by legislation or otherwise, to ensure, within their jurisdiction, that service suppliers do not engage in unfair trade practices, and that international standards and disciplines for the control of such practices and a multilateral mechanism to enforce such standards and disciplines are expeditiously put in place.

At Marrakesh, competition policy was included among the priority items for discussion in the WTO, though it has not been put formally on the WTO agenda. This is partly because there is a wide gulf separating the positions of developed and developing countries on this issue, which is inherent in their respective interests and is yet to be articulated fully and publicly. The work done in the UNCTAD and the UN Centre for Transnational Corporations provides a good basis to build a competition policy at the international level. India should take the initiative to mobilise the support of developing countries for the inclusion of this subject as a principal item on the agenda of the developing countries for urgent negotiation under the WTO. Another issue relating to competition policy is the formulation of competitive laws to replace anti-dumping laws. Some regional trade agreements have already eliminated anti-dumping duties on intra-regional trade, by extending the scope of competition policy. Since the developing countries are the worst sufferers from anti-dumping measures, they should take the initiative of replacing such measures by an internationally agreed competition policy.

The developed countries have already succeeded in including on the WTO agenda the question of trade and environment and are making strenuous efforts to include an item on trade and labour standards. These two subjects raise some common issues, notably whether the trade rules should govern the production process, and whether the interest of the developed countries in seeking discussions on these subjects really arises out of their concern for the environment and the human rights of the workers in the Third World countries or these are merely a disguise for neo-protectionism. The entire edifice of the GATT rules has been held together by the concept of 'like products'. There is a danger of this edifice coming apart if GATT/WTO rules are applied not on the basis of like products but on the basis of the process of production, i.e., the manner in which technology and factors of production are employed for the manufacture of like products. The GATT panel verdict on the US-Mexico tuna-dolphin case was that technical standards governing the production process go well beyond the present GATT notion of like products.

The rise of the protectionist wave in the developed countries has been mainly due to the long-postponed adjustments in their industries in order to create space for competitive products from developing countries. Moreover, recently these countries, particularly the United States, have become concerned about the marked deterioration in the relative earnings of their unskilled labour, which they are attributing to cheap imports from low-cost countries. In the Uruguay Round, the developed countries have agreed to phase out the restrictive and discriminatory system of Multi-Fibre Agreement. They have agreed on Safeguards, Anti-Dumping and Countervailing measures which are more transparent than before. As a part of the Agreement on Safeguards they have also agreed to phase out grey area measures which were taken outside GATT to restrict imports of competitive items, other than textiles, from developing countries. Hence, the developed countries are concerned that with the commitment for liberalisation assumed by them under the Uruguay Round, their flexibility to protect their industries against competitive imports from developing countries is substantially reduced. This is an important factor pushing the governments of the developed countries to reintroduce protection through the backdoor by linking environmental and labour standards with trade.

The main economic argument given by developed countries is that free trade acts as a conduit for a downward harmonisation of environmental and labour standards, as the enterprises are encouraged to produce in countries and regions where environmental and labour standards are the lowest. Hence, there is a need of an upward harmonisation of these standards and linking them to trade. The basic argument against this linking of trade with environment and labour standards is that the norms and standards of environment and labour are a function of the stage of development of the economy. To impose on low income countries environmental and labour standards prevailing in advanced countries would, internally, artificially raise their costs of production and, externally, extinguish their comparative advantage in the export sector.

The developed countries have also argued that lower labour standards in developing countries give these countries an unfair advantage in trade which aggravates the unemployment situation in developed countries. However, as the latest UNCTAD *Trade and Development Report* (1995) argues, the occurrence of twin phenomena of rising unemployment in developed countries and growth in their imports from developing countries is a mere coincidence. Not all manufactured exports from developing countries are labour-intensive. Neither does their competitive advantage always derive from cheap labour. Besides, empirical studies show that the quantitative impact of environmental and social dumping is quite small. As regards the decline in the relative wage levels of unskilled workers in developed countries, several studies have shown that the decline is due to skill-based technological change rather than cheap imports from developing countries [Krugman and Lawrence, 1993; Bhagwati and Kosters, 1994].

Furthermore, there is wide variation among developed countries themselves in the environmental and labour standards applied by them. For example, workers' participation in decision-making on the operation of the plant is more wide-spread in Europe than in the United States. Coming to international labour standards, each international convention laying down such standards, has its own qualifications and limitations. Most of these standards make allowance for countries at lower levels of development. The international organisations where these conventions have been adopted have devised procedures and mechanisms of their own to seek the implementation of these conventions. There are also commensurate legislations and mechanisms at the national level. There is no reason why all these arrangements should be disregarded and these norms and standards should be incorporated into the WTO, unless the objective is to seek their implementation through the WTO retaliation procedure.

International trade is only one of the factors affecting the economic and social conditions of workers in both developed and developing countries. If the real concern is the social conditions of workers, then all these factors, and not only international trade, must be taken into account. The fact that the social condition of the workers is not the real concern is also demonstrated by the following: Firstly, international labour standards do not cover the unorganised and informal sectors where more than 90 per cent of the Indian workforce is concentrated. Secondly, workers engaged in trade-related production constitute only a small percentage of workers in the entire production activity. Thirdly, the trade restrictive effect of the insertion of the social clause in the WTO will adversely affect the interest of workers in both, the developed and developing countries. In the developed countries, higher import costs may have an adverse effect on GNP and on the real wages of the workers. In the developing countries, it will artificially raise labour costs which will have a negative effect on output, exports and hence employment opportunities in these countries. Fourthly, linking labour standards with trade targets only those developing countries which have succeeded in building competitive advantages in certain lines of exports over developed countries, not those developing countries which do not pose a competitive threat and where labour standards are either non-existent or wantonly violated.

In any event, there is no justification for seeking an equalisation of wage levels across the countries of the world. There can be no globalisation of wage levels without the globalisation of the levels of development and technology. The highly industrialised countries have a deliberately contrived ambivalent attitude on the issue of the globalisation of wage levels. Recently, the Deputy Assistant Secretary, International Labour Affairs, US Department of State, referred to the desirability of 'levelling the playing field by reducing wage differentials' and, in the same breath, mentioned that 'the USA is not seeking to deny the principle of comparative advantage based on lower labour costs in developing countries'.

Moves towards bringing new areas under GATT/WTO discipline have proceeded very fast since the adoption of the Final Act. In particular, the consideration of the link between trade and the environment has progressed rapidly. At Marrakesh, it was decided to direct the first meeting of the WTO General Council to establish a Committee on Trade and Environment after the entry into force of the WTO, which should report to the first Biennial Meeting of the Ministerial Conference. Pending the convening of the first meeting of the General Council, the work of the proposed committee was carried out by a Sub-Committee of the Preparatory Committee of the WTO. The terms of reference of this Sub-Committee were laid down in considerable detail and depth in a Decision taken at the Marrakesh Meeting. The Sub-Committee and subsequently the full-fledged Committee on Trade and Environment, established after the entry into operation of the WTO, have made considerable progress in their work.

As in the case of TRIPS, the UN specialised bodies whose sole vocation is to deal with these subjects, i.e., UNEP for environmental standards and ILO for labour standards, are being side-stepped and an attempt is being made to establish the new regimes in the WTO. This is because the WTO Agreement provides for retaliatory sanctions for the enforcement of these standards, whereas no UN specialised body is equipped to impose such a sanction or with any other really effective instrument of enforcement. Starting from the Havana Conference in 1948, persistent efforts have been made to bring the question of labour standards into the discussion of trade issues. The Havana Charter recognised that 'unfair labour conditions, particularly in the production for exports, create difficulties in international trade'. There was, however, no provision in the Charter on an international regime for linking trade with labour standards. The USA tried in 1979, 1987 and 1990, to get labour standards discussed in GATT, but was unable to forge a consensus in favour of its proposal. The international labour standards which the major developed countries want to be included in the trade regime under the WTO are:

(a) Freedom of Association (ILO Convention No. 87).
(b) Right to Organise and to Collective Bargaining (No. 98).
(c) Forced Labour Convention (No. 29).
(d) Equal Remuneration Convention (No. 100)
(e) Minimum Age Convention (No. 111).

The developed countries are exerting tremendous pressure to get the link between trade and labour standards widely accepted. In this, the Governments of the countries of the North have been joined by their transnational corporations, their trade unions and their non-governmental organisations (NGOs) active in the field of environment and human rights. There is also pressure from their legislatures, including the US Congress and the European Parliament, to apply restrictions on imports from developing countries which do not apply stipulated labour standards. Appropriate provisions on this subject are included in the NAFTA and in the Treaty establishing the European Union. Observance of minimum labour standards has been put in the US preferential scheme as a condition for granting preferences. The World Bank includes environmental assessment as a part of its project development and appraisal, and a 1994 US legislation requires the Bank to include compliance with minimum labour standards by the borrowers as a condition for lending.

XI. CONCLUSIONS, CRITICAL CHOICES AND STRATEGIES

Conclusions

The international trading system that has emerged from the Uruguay Round is a combination of highly qualified and only partially liberal multilateralism, discriminatory regionalism and arbitrary unilateralism. It bears a striking resemblance to the present international security system which is a combination of limited and qualified multilateralism, regionalism based on the outmoded concept of balance of power, and arbitrary unilateralism. Besides, there can be no truly liberal multilateral trading system until there is a curb on restrictive business practices of the TNCs. No international regime is envisaged to control these practices.

Nobody now talks about 'free trade'; all that one aspires for is 'fair trade'. 'Fair trade' itself has become a highly subjective concept and all kinds of crimes including adoption of measures, which directly contravene the principles of liberal trading, are committed in the name of 'fair trade'.

Another important feature of the nascent international trading system is the proliferation of discriminatory regionalism. Article XXIV of the GATT permits a departure from the MFN principle for the purpose of establishing a free trade area or a customs union. No proposal was made during the Uruguay Round negotiations to delete or otherwise substantively tamper with Article XXIV. While earlier, regionalism was justified on the ground of economies of scale and the trade-creating effects of regional groupings, modern regionalism is technology-driven. Modern technology makes it essential to produce on a global scale and command the largest possible resources and markets, to be able to stay ahead in competition. This calls for merger of markets which has been the motivating force behind the integration of the European market, NAFTA and various proposals for regional groupings in South-East Asia and East Asia.

Regional integration by definition involves practising discrimination against the countries outside the integration scheme. The immediate and medium-term effect is to discriminate against the inflow of goods and services from outside countries, and in the outflow of capital and technology to these countries. In the longer run, the trade-creating effects of an integration scheme are expected to swamp the trade-diverting effect. But with the growing complexity of and imbalances in the world economy and owing to the increasing intrusion of non-economic factors, the trade-creating effects of a regional integration scheme have become highly problematic and elusive. As a consequence, the prospects of countries outside such schemes are very bleak. Most of the countries of Africa and the South Asian countries today find themselves in this situation. Some of these countries have formed groupings of their own, but these have not really taken off.

In the post-Second World War reconstruction of the international system, Keynes attached priority to building first the international monetary system and then proceeding to put in place an international trading system to buttress the monetary system. For, he knew that exchange rate variations and distortions could neutralise all efforts to operate an orderly trading system. Today, after the establishment of the WTO, the situation is reversed. We have an international trading system without there being a worthwhile international monetary system. After the transition to the floating exchange rate system, the IMF is no longer discharging the functions assigned to it in its statute to regulate exchange rates. An international trading system, operating in conditions of exchange rate volatility, misalignment of currencies and massive-scale, untrammeled currency speculation, cannot function in an orderly and effective manner. The international trading system under the WTO, therefore, suffers from basic uncertainty and unpredictability. The developing countries were forced by the circumstances to join the Uruguay Round of negotiations and accept its outcome containing far-reaching and, generally, one-sided commitments on their part. Most of the developing countries actively participated in the later stages of the negotiations and subsequently joined the WTO. A large number of them, which were not members of GATT, acceded to GATT during the course of the Uruguay Round and several of them are currently engaged in negotiations with a view to acceding to the WTO.

Critical Choices

In this context, a question that is frequently asked is: When almost all developing countries including China, have either joined the WTO or are knocking at its door, was it possible for India to have stayed out of it? This is, of course, a hypothetical question because the fact is that India has already joined the WTO. So long as we are following a policy of far-reaching internal and external liberalisation, there was no need for us to have stayed out of the system. For we have gone much further in our liberalisation policy than what we are required to do under the Uruguay Round agreements. This is particularly true in the areas of tariff reduction and measures designed to facilitate the inflow of foreign private investment.

Modifications, if not a reversal, of this policy are essential if we want to safeguard and recapture domestic economic space in the critical areas. The basic modification required is to reduce the extent of our dependence on foreign markets and foreign private capital for realising our development goals and resume the path of self-reliant growth, without isolating ourselves from the rest of the world. We need a development policy based on an alternative paradigm.

The first priority in any alternative paradigm should be to create the minimum social and political conditions which are indispensable for the success of any development strategy. These are also the conditions for holding our nation together. Moreover, these are the commitments we have undertaken in our Constitution, but have not so far fulfilled. These are the commitments of equality, democracy and secularism.

Secondly, we must mobilise resources of our own for the massive investment that is needed in infrastructure, for human resources development, in the social sectors, and for research and development. Very few countries in the world have grown, except by their own resources. Even foreign investment is unlikely to come in the absence of the availability of domestic resources.

Thirdly, we should be able to integrate with the global economy at the axes of our choice, also be able to follow a policy of selective delinking from the global economy for the development of technological capability in some of the key and sensitive sectors of our economy. We followed such a policy for developing our capabilities in the nuclear and space fields and achieved spectacular results.

Fourthly, we should consciously avoid adopting those measures of liberalisation which have the effect of enhancing our economic and political dependence on other countries. This should include financial sector liberalisation carrying the risk of flight of capital, external liberalisation involving imports of consumer goods designed to meet the demands of the elites of the society, and measures which will further increase the existing colossal burden of foreign debts. We should also quickly devise and implement a plan to liquidate our foreign debts before we fall into the debt trap and start swapping our real resources for reducing our debt burden.

Instead of misleading the people in an attempt to do a hard sale of the WTO agreements, the Government of India should explain both the pros and cons of their main provisions and leave it to the people and Parliament to decide the extent to which our laws should be brought in conformity with the agreements. If the people and Parliament decide not to amend or replace existing legislations, the government will have to abide by their wishes and take a firm stand to uphold them. This would put the onus on the rest of the members of the WTO to accommodate us and modify the take-it-or-leave-it character of the Uruguay Round package.

Strategies

More specifically, we should take full advantage of the flexibility and loopholes in the WTO agreements, to retain control over economic decision-making and policy formulation. The best opportunity to do so will be in the legislations that we will be enacting to give effect to our commitments under the Final Act. We should build our public opinion and mobilise other developing countries in favour of our own interpretation of the important provisions of the WTO agreements.

India should, at the same time, make domestic preparations to face the reality of the new trading order. For this we will have, above all, to upgrade our technological capability, make large-scale investments in infrastructure, and develop our human resources. Per capita expenditure in R&D in India is one of the lowest in the world. It is only $ 3 as against $ 700 in Japan, $ 600 in the USA and $ 400 in Canada. Development of technology cannot be left to the private sector alone. The government has to play a crucial role in this area. It is again the government which can invest in and support the development of appropriate technologies and the application of advanced technologies in the small-scale industrial sector.

Minimising the Damage: In order to minimise the harm that can be caused to our interest by some of the WTO agreements, we need to monitor very carefully the future evolution of the rules and practices under the various regimes established under the WTO, and coordinate our effort with other developing countries to take joint action to protect our interests. With a view to preventing developed countries from reintroducing grey area measures under the legal cover of some of the agreements of the WTO, we must guard against the introduction through the backdoor of discriminatory protectionism under the Agreement on 'Anti-Dumping Measures' and that on Safeguards, including the special safeguards provided in the Agreement on Textiles and Clothing and on Agriculture. Then again, several of the agreements under the WTO, particularly those on TRIPS, TRIMs, Services and Agriculture, are likely to put severe strain on our balance-of-payments position. We should be very circumspect in implementing the relevant provisions of these agreements. In this context, we should be particularly careful in accepting access commitment in the sector of financial services. Liberalisation of the financial sector should come last in the sequence of economic reforms, only after the achievement of macro-economic stabilisation and the commencement of export-led growth. When the liberalisation of this sector is undertaken, priority should be accorded to measures for enhancing the efficiency of the domestic financial sector and strengthening domestic financial and monetary institutions. Special precaution should be taken to ensure that liberalisation commitments undertaken in this sector do not lead to short term and speculative capital inflows.

We should carefully monitor the liberalisation plan of each major importer and take advantage of the review at each phase of the integration of MFA into GATT, to press for steady and credible progress towards final integration. All attempts to use the financial powers of the IMF and World Bank to reinforce the WTO disciplines on developing countries and use the WTO sanctions to reinforce IMF/World Bank conditionalities must be resisted. Trade policy review by the WTO should not be allowed to become a prerequisite for access to Fund/Bank resources.

Preparations for Continuing Negotiations: The WTO has become a forum for continuing negotiations. We will now have to be prepared to engage in negotiations under the aegis of the WTO on a range of issues on a continuing basis. Some of the negotiating issues are already identified in the Final Act; the others we should be able to anticipate. The following are some of the relevant issues.

(i) Trade and environment.
(ii) Negotiations on Subsidies, Safeguards, Professional Services, Basic Telecommunications and Government Procurement - all in the service sector, to be completed by 1996.
(iii) Negotiations on audio-visual and maritime services, to start within three years.
(iv) Negotiations in other service sectors to be completed within five years.
(v) Negotiations for the continuation of the agricultural reform process, to be initiated one year before the end of the implementation period, i.e., 1999.
(vi) Review of the implementation of the Textile Agreement before each phase, i.e., 1998, 2001 and 2005.
(vii) Review of the question of patentability - 1999. And
(viii) review of the TRIMs Agreement - 2000.

India should take initiatives for organising consultations among developing countries on these negotiating issues, in common forums like NAM, G-77, G-15 and regional groups of developing countries. A study on the experience of the NAM countries during the Uruguay Round negotiations, with an analysis of the negotiating strengths and weaknesses of the developing countries during the negotiations, can be of great use and help to the developing countries, as they confront the new negotiating challenges in the WTO.

Developing Countries' Own Agenda for Negotiation: The agenda for negotiations is set by developed countries. If the developing countries are to meet the challenge of the new world trading order, they must have their own agenda for the forthcoming negotiations. The following items could be included in the agenda which India should project and round which a consensus can be built among the developing countries:

For Renegotiation:
(a) Dispensing with anti-dumping measures
(b) Excluding the provision on quota modulation in the Agreement on Safeguards.
(c) Securing free movement of labour for employment in other member countries. It will carry credibility, only if we are prepared to open our own economy to labour from our neighbouring countries.
(d) The Agreement on TRIPS should be renegotiated for achieving the following purposes:
  (i) To ensure that patenting of life is not given an international legal sanctity.
  (ii) To get the provision on the patenting of plant variety deleted on the ground that, in effect, it amounts to the patenting of plants themselves.
  (iii) To include in the Agreement explicit recognition of the principle of protection of the public interest and provision for compulsory licensing.
  (iv) To include a provision which adequately protects the farmers' rights.

For Introducing New Issues: (a) *Competition Policy:* Establishing an international regime on competition policy, with the focus on controlling the restrictive business practices of transnational corporations. (b) *Keeping Certain Issues Outside WTO:* Subjects which are best dealt with by other organisations of the UN system, particularly, UNCTAD, ECOSOC and the General Assembly, include commodities, resource-flow, debt, technology transfer, poverty alleviation, etc. Bringing these subjects to the WTO will encourage the imposition of cross-conditionalities on the developing countries, apart from eroding the authority of the UN proper and its subsidiary bodies like UNCTAD. (c) *South-South Co-operation:* The developing countries should, in particular, forge a common strategy on the interpretation of and the best way of giving effect to some of the important provisions of the Agreement on TRIPS. They should co-operate in the design of national legislations and social policies to safeguard the public interest and achieve their development objectives in the process of the implementation of the TRIPS Agreement.

There is also considerable scope for co-operation among them for facilitating adjustments to the new regimes and rules and regulations of the WTO. They can help each other in building enforcement and administrative capacities, in strengthening national institutions and in devising legislative and regulatory mechanisms to cope with the problems posed. Given India's long experience of GATT and its strong institutional capabilities, it is in a uniquely advantageous position to co-operate with other developing countries in all these areas. Such co-operation can be extended bilaterally as well as as a part of schemes of the South-South Co-operation adopted by the Non-aligned Movement, the Group of 77 or the Group of 15.

ABBREVIATIONS

ACP	African, Caribbean and Pacific States.
AMS	Aggregate Measurement of Support.
CAIRNS Group	An informal coalition of developed and developing countries formed in Cairns, a small town in Australia, and committed to seeking maximum liberalisation in agricultural trade.
Cross-Retaliation	Denial or withdrawal of tariff concessions in one sector (say goods) in retaliation against non-fulfilment of access commitment in another sector (say services).
Draft Final Act	The Draft prepared in 1961 by Arthur Dunkel, the then Director General of GATT, containing the outcome of the Uruguay Round of Trade Negotiations also known as the Dunkel Draft.
DSB	Dispute Settlement Body as provided for in the Understanding on Rules and Procedures Governing the Settlement of Disputes.
EC	European Community.
EU	European Union.
FAO	Food and Agriculture Organisation of the United Nations.
Final Act	The document adopted at the Marrakesh Ministerial-level Meeting incorporating the outcome of the Uruguay Round.
GATS	General Agreement on Trade in Services.
GATT 1947	General Agreement on Tariffs and Trade, dated October, 1947, as subsequently rectified, amended or modified.
GATT 1994	It consists of (a) GATT 1947, (b) the provisions of the legal instruments that entered into force under the GATT 1947 before the date of entry into force of the WTO Agreement, (c) Understandings reached during the Uruguay Round of Trade Negotiations on certain provisions of GATT 1947, and (d) the Marrakesh Protocol to GATT 1994.
GNP	Gross National Product.
GSP	Generalised System of Preferences.
ICITO	Interim Committee for the International Trade Organisation.
ILO	International Labour Office.
IMF	International Monetary Fund.
IPRs	Intellectual Property Rights.
ITC	International Trade Centre.
ITO	International Trade Organisation, provided for in the Havana Charter.
ITU	International Telecommunications Union.
MFA	Multi-Fibre Agreement.
MFN	Most-Favoured-Nation principle.
MTO	Multilateral Trade Organisation, as proposed in the Dunkel Draft.
NAFTA	North American Free Trade Association.
NAM	Non-Aligned Movement.
OECD	Organisation for Economic Co-operation and Development.
Paris Convention	Convention for the Protection of Industrial Property, originally concluded in 1883; the last revision made in 1967 at a Conference in Stockholm.
Part IV of GATT	This Part of GATT dealing with Trade and Development was adopted in 1965.
R&D	Research and Development
TNCs	Transnational Corporations.
TRIMs	Trade Related Investment Measures.
TRIPS	Trade Related Aspects of Intellectual Property Rights, includings Trade in Counterfeit Goods.
UNCTAD	United Nations Conference on Trade and Development.
UNDP	United Nations Development Programme.
UNEP	United National Environment Programme.
WIDER	World Institute for Development Economics Research.
WIPO	World Intellectual Property Organisation.
WTO	World Trade Organisation, the organisation underpinning the present international trading system.

Appendix I

De Minimis Provisions in WTO Agreement

1. Safeguards

Safeguard measures shall not be applied against a product originating in a developing country Member so long as its share of imports of the product concerned in the importing Member does not exceed 3 per cent, provided that developing country Members with less than 3 per cent import share collectively account for not more than 9 per cent of total imports of the product concerned (Article 9(1) of the Agreement on Safeguards).

2. Anti-Dumping

'—There shall be immediate termination (of investigations) in cases where the authorities determine that the margin of dumping is *de minimis*, or that the volume of dumped imports, actual or potential, or the injury, is negligible. The margin of dumping shall be considered to be *de minimis* if this margin is less than 2 per cent, expressed as a percentage of the export price. The volume of dumped imports shall normally be regarded as negligible if the volume of dumped imports from a particular country is found to account for less than 3 per cent of imports of the like product in the importing Member, unless countries which individually account for less than 3 per cent of the imports of the like product in the importing Member collectively account for more than 7 per cent of imports of the like product in the importing Member' (Article 5(8) of the Agreement on Implementation of Article VI of GATT 1994).

3. Subsidies

Least developed countries and those with an annual income below $ 1,000 may continue to use prohibited subsidies without risk of countervailing action until their exports of a product are considered competitive - defined to involve a 3.25 per cent share of world trade for two consecutive years (Article 27(2) of the Agreement on Subsidies and Countervailing Measures).

Any countervailing duty investigation of a product originating in a developing country Member shall be terminated as the authorities concerned determine that:

(a) the overall level of subsidies granted upon the product in question does not exceed 2 per cent of its value calculated on a per unit basis; or

(b) the volume of the subsidised imports represents less than 4 per cent of the total imports of the like product in the importing Member, unless imports from developing country Members, whose individual shares of total imports represent less than 4 per cent, collectively account for more than 9 per cent of the total imports of the like product in the importing Member (Article 27(10) of the same Agreement).

Appendix II

Chronology of Events

Havana Conference and entry into force of GATT	1948
Conclusion of the Tokyo Round of Trade Negotiations.	1979
The GATT Ministerial Meeting in which the idea of a new round of trade negotiations covering new areas like TRIPS, TRIMs and Services, was mooted.	November, 1982
Launching of the Uruguay Round of Trade Negotiations at Punta del Este	September, 1986
Mid-term Review of the negotiations at the Ministerial level in Montreal	December, 1988
Resumed Mid-term Review in Geneva when, among others, it was conceded that norms and standards of IPRs can be brought within the scope of the negotiations.	April, 1989
Presentation of a Draft Final Act by Arthur Dunkel incorporating the outcome of the negotiations.	December, 1991
Agreement reached on the Final Act.	December 15, 1993
The Final Act formally approved and signed at the Ministerial level in Marrakesh, Morocco.	April 15, 1994
Entry into force of the WTO	January 1, 1995

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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:

Commission on Centre-State Relations, Report, Part I, 1988 (Chairman: Justice R.S. Sarkaria), Government of India, New Delhi, Chapter X.

COMMISSION ON CENTRE-STATE RELATIONS

CHAPTER X FINANCIAL RELATIONS

1. INTRODUCTION

10.1.01 Mobilisation, sharing and utilisation of financial resources play a very crucial role in all systems of multi-tier government and can give rise to difficult problems of inter-governmental relations unless handled in a spirit of mutual understanding and accommodation.

10.1.02 In some of these systems, the national and lower tiers of government have concurrent powers in regard to certain taxes, borrowings and outlays. This concurrency of jurisdiction often results in serious economic and administrative problems which have to be sorted out through difficult negotiations, compacts or resort to courts.

10.1.03 In other bifurcated systems, there is clear-cut division of the powers of taxation and borrowings between the national and lower levels of government which, by its very nature, can rarely match their re-sources and needs. It requires a mechanism for adjusting the surpluses and deficits, and reducing unavoidable vertical or horizontal imbalances of different constituent units, through resource transfers.

10.1.04 India falls in the latter category. The Constitution allots separate legislative heads of taxation to the Union and the States. There are no taxes in the sphere of their concurrent jurisdiction. Borrowing and foreign exchange entitlements are controlled by the Union.

10.1.05 The Constitution envisages an institution of a quasi-judicial character, the Finance Commission, which is set up periodically, for advising the President, among other things, on the division of certain tax revenues raised by the Union, between the Union and the States. The recommendations of the Finance Commission are based on certain norms evolved by it in respect of growth rates of taxes, levels of expenditure, returns on investment, etc. Since the Finance Commission is constituted only periodically, the assumptions made by it remain broadly 'static' during the period covered.

10.1.06 There is a second institution, the Planning Commission, set up by an executive order of the Union Government regarding the desirable transfer of resources to the States over and above those recommended by the Finance Commission. Its recommendations cover, among other things, feasible changes in tax rates and efforts by both, quantum and allocation of borrowings between the Union and the States. Since the Planning Commission is a continuing body, its recommendations are based on 'dynamic' assumptions which take into account the changes in the economic structure.

10.1.07 Bulk of the transfer of revenue and capital resources from the Union to the States is determined largely on the advice of these two Commissions. During the Sixth Five-Year Plan (1980-85), about 41 per cent of total resources transferred from the Union to the States was done on the advice of the Finance Commission and over 43 per cent was done on the advice of the Planning Commission.

10.1.08 Apart from the above, the Union Government also makes certain other transfers to the States. These comprised 15 to 16 per cent of the total resources transferred from the Union to the States during the Sixth Plan period. Of the total revenue and capital resources raised by the Union and the States, the share of the two was roughly equal after these transfers.

(10.1.09 not inserted)

10.1.10 This Chapter has been divided into ten Sections, including the Introduction (Section 1). Section 2 of this Chapter gives a broad account of the historical evolution of Union-State financial relations and an outline of Union-State financial arrangements provided in the Constitutions. Section 3 enumerates the various issues and problems raised in the Union-State financial relations. Section 4 contains a factual review of the trends in respect of growth in revenues and sharing of resources between the Union and the States. Section 5 deals with the suggestions for enlargement of States' resources by transferring more taxation powers to them. Section 6 deals with the issues in the enlargement of the sharable or divisible pool. In Section 7, the complaints regarding the pattern of devolution have been considered. Section 8 examines the various issues relating to the working of the Finance Commission mechanism. Section 9 and 10 are devoted to the examination of the remaining issues, e.g., allegations regarding Union Government's decisions adversely affecting States' finances, indebtedness of States, overdrafts, sharing of capital resources and some operational irritants.

2. HISTORICAL BACKGROUND

(10.2.01 to 10.2.11 not inserted).

CONSTITUTIONAL PROVISIONS IN OUTLINE

10.2.12 Chapters I and II of Part XII of the Constitution contain the main provisions governing the Union-State financial arrangements. Of these, Articles 268 to 270 and 272 deal with taxes levied by the Union, the proceeds of which are either assignable to the States, or compulsorily or optionally sharable with the States. Article 275 provides for grants-in-aid of revenues made under a law by Parliament to States in need of assistance. Article 275 provides for grants-in-aid of revenues made under a law by Parliament to States in need of assistance. Article 282 contains a provision for grants by the Union or a State for any public purpose. Articles 276 and 285 to 288 put certain limitations on the taxation powers of the States. Article 274 requires prior recommendation of the President to Bills affecting taxation in which the States are interested. Article 289 exempts the property and income of the States from Union taxation. Article 280 requires the constitution of a Finance Commission every five years or earlier. Clause (3) of this Article sets out the duties of the Finance Commission. Article 281 requires the recommendations of the Finance Commission together with an explanatory memorandum about the action taken thereon, to be placed before Parliament. Articles 292 and 293 define the borrowing powers of the Union and the States.

10.2.13 Financial arrangements under the Constitution have two main aspects. One relates to distribution of taxation heads, and the other to distribution of revenues and sharing of resources between the Union and the States. Articles 246, 248 and 265, read with the Legislative Lists I and II, constitute the core of the first aspect, while the main provisions relating to the second aspect are contained in Chapters I and II of Part XII of the Constitution.

DISTRIBUTION OF TAXATION POWERS

10.2.14 Legislative Lists I and II of the Seventh Schedule to the Constitution enumerate the general subjects of legislation separately from the heads of taxation. The distinction construed in the light of Articles 246 and 265 implies that no tax can be levied unless it is related to a specific head of taxation in List I or List II. The Constitution provides in Lists I and II, separate heads of taxation for the Union and the States. There is no head of taxation in the Concurrent List. This means, the Union and the States have no concurrent power of taxation. The residuary power of taxation vests in the Union. There are thirteen taxation heads comprised in Entries 82 to 92B in the Union List and nineteen taxation items comprised in Entries 45 to 63 of the State List. The detailed particulars of these Entries in List I and List II are given in Annexure X.1 (Not inserted).

10.2.15 Allocation of the heads or taxation between the Union and the States is based on the broad principle that taxes which are location-specific and relate to subjects of local consumption have been assigned to the States. Those taxes which are of inter-State significance and where the tax-payer can gain or evade tax by shifting his habitat, or where the place of residence is not a correct guide to the true incidence of tax, have been vested in the Union. This clear-cut division of heads of taxation between the Union and the States has minimised the scope for conflict and litigation between them.

DISTRIBUTION OF REVENUES

10.2.16 The taxation powers allocated to the Union and the States are mutually exclusive. But the scheme of accrual of revenues envisages total assignment to the States of the net proceeds of specified taxes and sharing of some others by them. This scheme contemplates:

(a) Certain stamp duties and duties of excise on medicinal and toilet preparations mentioned in the Union List are to be levied by the Union but collected by the States and the proceeds shall not form part of the Consolidated Fund of India but assigned to the States in which collected (Article 268).

(b) Taxes mentioned in Article 269(1)[1] levied and collected by the Union but assigned to the States, within which they are levied, as laid down in Article 269(2).

(c) Taxes levied and collected by the Union but shared with the States, viz., tax on non-agricultural income (Article 270).[2]

(d) Taxes which are levied and collected by the Union but may be shared with the States, if Parliament by law so provides, viz., Union Excise Duties[3](Article 272).

(e) Taxes in the Union List levied, collected and retained by the Union subject to the exceptions mentioned above.

(f) Taxes in the State List, levied, collected and retained by the States.

GRANTS

10.2.17 The Constitution Provides for payment by the Union of such sums as Parliament may by law provide each year as grants-in-aid of the revenues of such States as Parliament may determine to be in need of assistance. Besides, the Union Government is required to give grants-in-aid to the States for the welfare of the Scheduled Tribes and for raising the level of administration in the Scheduled Areas and separately for Assam (Article 275).

10.2.18 Apart from the above provisions, under the heading 'Miscellaneous Financial Provisions' Article 282 provides that the Union or a State *may* make any grants for any public purpose notwithstanding that it is not one with respect to which Parliament or a State Legislature may make laws. Thus, a distinction has been made in the Constitution between grants under Article 275 and those under Article 282. The former (except those covered by the proviso to Article 275) are made in accordance with the recommendations of the Finance Commission. However, under Article 282 the Union as well as the States may make grants for any public purpose. The use of the word 'may' in this article has been taken to signify the discretionary nature of these grants.

(10.2.19 not inserted).

BORROWING POWERS

10.2.20 The executive power of the Union extends to borrowing upon the security of the Consolidated Fund of India within such limits, if any, as may from time to time be fixed by Parliament by law and to the giving of guarantees within such limits, if any, as may be so fixed. Similarly, the executive power of a State extents to borrowing upon the security of the Consolidated Fund of the State within such limits, if any, as may from time to time be so fixed. However, the executive power of the States extends to borrowing within the territory of India only. Further, the Government of India *may*, subject to such conditions as may be laid down by or under any law made by Parliament, make loans to any State or, so long as any limits fixed under Article 292 are not exceeded, give guarantees in respect of loans raised by any State, and any sums required for the purpose of making such loans shall be charged on the Consolidated Fund of

1 (a) duties in respect of succession to property other than agricultural land; (b) estate duty in respect of property other than agricultural land; (c) terminal taxes on goods or passengers carried by railway, sea or air; (d) taxes on railway fares and freights; (e) taxes other than stamp duties on transactions in stock exchanges and futures markets; (f) 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; (g) 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.

2 Taxes mentioned in Articles 269 and 270 do not form part of the Consolidated Fund of India, but a surcharge levied on these taxes under Article 271, does so.

3 The proceeds of these duties form part of the Consolidated Fund of India. Article 266(3) mandates that no money out of this Fund shall be appropriated except in accordance with law. Consistently with this principle, the sharing of these duties has been made dependent upon Parliamentary legislation.

India. But a State may not without the consent of the Government of India raise any loan if there is still outstanding any part of a loan which has been made to the State by the Government of India or by its predecessor Government, or in respect of which a guarantee has been given by the Government of India or by its predecessor Government. A consent under Article 293(4) may be granted by the Government of India subject to such conditions, if any, as the Government of India may think fit to impose.

10.2.21 Flexibility and objectivity in revenue-sharing between the Union and the States are important features of the constitutional scheme. Sources of revenue with the Union are not entirely meant for its exclusive use but are to be shared with the States, mandatorily in the case of Income Tax other than on agricultural income, and optionally, with the approval of Parliament, in the case of Union Excise Duties. Proceeds of duties and taxes levied by the Union under Articles 268 and 269 are wholly assignable to the States.

10.2.22 In all the federations of the world, the revenues of the federal governments have grown enormously during the past half a century. Concurrent taxation powers, as in the case of United States of America, had led to much litigation and difficulties which are inherent in any overlapping tax system. Similarly, as in Australia and Canada, negotiations and agreements played an important role in determining the shares in the proceeds of taxes. Even in West Germany, the evolution of tax sharing arrangements took many years after the introduction of the Basic Law. Yet, when political expediency holds sway conventions have the uncanny habit of going underground.

10.2.23 In our country, the determination of shares of the States in the aforesaid taxes and duties and their *inter se* allocation as also of grants-in-aid of revenues, follows the recommendations of the Finance Commission. Unlike the Commonwealth Grants Commission of Australia, the Indian Finance Commission is a constitutional body and the objectivity in its role has been facilitated by keeping it outside the Union executive. Compared with its Australian counterpart, the Indian Finance Commission has a greater scope inasmuch as it recommends sharing of tax proceeds also, besides the grants-in-aid, and advises on other matters referred to it in the interests of sound finance. The absence of clear constitutional provisions for revenue sharing created many problems in other federations and they had to evolve a variety of arrangements to overcome them. For example, in Canada, tax-rental arrangements were resorted to. In Australia, the Australian Commonwealth Grants Commission was set up to consider allocation of grants among the claimant States. Specific-purpose grants, with strict enforcement conditions, came into existence in countries like U.S.A.

3. THE COMPLAINTS AND ISSUES

NEEDS AND RESOURCES

10.3.01 In the evidence of the State Governments, some political parties and several experts before us a common thread is seen, viz., the resources allocated to the States are not adequate to enable them to discharge their responsibilities. The State Governments, as well as some all-India political parties have claimed that not only the States' resources are relatively inelastic but also that their tax-base is narrow. Of the various taxes levied by them, Sales Tax alone and, to a lesser extent, the State Excise Duties, have exhibited a significant degree of elasticity. However, some of the other resources like Land Revenue have today lost importance. The yield from Land Revenue including cesses, etc., for all States in 1951-52 was about Rs 49 crore comprising 21.3 per cent of their own tax revenue and in 1984-85 it was about Rs 318 crore constituting only 2.6 per cent of their own tax revenue.[4]

10.3.02 The States have pointed out that the Constitution has assigned to them the responsibility for building up vital social and industrial infrastructure, which is an essential pre-requisite for rapid socio-economic development. They are responsible for rural development, education, medical and public health facilities, welfare of

4 Government of India, Ministry of Finance - *Indian Economic Statistics, Vol. II, Public Finance,* 1964 and 1986.

Scheduled Castes and Scheduled Tribes, etc. Further, they have to spend large sums on the development of roads, generation and distribution of power, etc., which are essential for industrial development. These responsibilities, particularly the creation of social infrastructure, involve large investments which do not yield immediate or direct returns. The maintenance cost of the social and economic infrastructure has also increased by leaps and bounds. Apart from the above, the expenditure on non-developmental activities like maintenance of law and order, has also shown large increases, particularly in the wake of emergence of fissiparous tendencies and divisive forces. Over the years, the general administrative costs have risen steadily and today they form a large part of the States' expenditure. Inflation has made the situation worse. Faced with high cost of administration and inflation, the States complain of ever-widening gap (often referred to as the vertical fiscal gap) between their own resources and needs. Some studies in the field of federal finance have compared the levels of expenditure of the States with their 'own' resources and pointed out the existence of significant gaps between them. It has been argued that these gaps are a measure of the large dependence of the States on the Union for resources and indicate a weakness in the existing arrangements.

10.3.03 States argue that in order to enable them to discharge their responsibilities properly, there is need for ensuring correspondence between their obligations and resources. It has been suggested that for this purpose, more rational system of savings and credit allocation should be evolved and the power and scope of various institutions - Finance Commission, Planning Commission and the National Development council - should be suitably redefined.

10.3.04 It has been pointed out by a State Government that the heavy dependence of the States on the Union for financial resources has resulted in progressive erosion of the jurisdiction, authority and initiative of the States in their own constitutionally defined spheres. Further, it has manifested in a gradual decline in the relative share of States' Plan outlay in the total, growing outlay of the Union on State subjects, proliferation of Centrally Sponsored Schemes and Union's tight control over planning in the States.

10.3.05 Some political parties have also emphasised that the States' resources should be commensurate with their expenditure needs. Indeed, an all-India political party has observed: 'If States suffer from inadequacy of financial resources and powers, the autonomy of States faces serve constraints and the federal character of the Constitution is also jeopardised.'

10.3.06 On the other hand, the Union Ministry of Finance has argued that the Union also is facing a widening gap between resources and needs. It has also pointed out that its own resources are no more elastic than those of the States. Further, defence, interest payments and subsidies take away the bulk of Union revenues. It has argued that there is need for the States to make greater efforts to increase resources within their existing powers before seeking more powers or larger Central assistance. It has pointed out: 'Though agriculture contributes nearly 40 per cent of the GDP, States have made no attempts to tap this source. Another disturbing feature is that the power and irrigation projects which are executed at enormous costs are not providing, sufficient returns to the State Governments'.

10.3.07 An all-India political party has argued along the same lines and concluded: '..... the complaint of the States regarding an inadequate and inelastic tax-base appears to be unfounded. The potential tax base available for the States is quite large and relatively more elastic. If effectively managed, the tax-base of the States can yield much larger revenues and this alone would solve the present problems. In a situation of over-all resource constraint, maximum effort at mobilisation of resources is required on all fronts and mere transfers of additional resources from the Centre can only be a temporary measure at the cost of wider national interests'.

THE BASIC SCHEMES

10.3.08 The criticism of the existing arrangements of allocation of resources should be considered in the light of the constitutional scheme and the manner in which it has worked over the years. Most of the States are of the view that the existing constitutional arrangements are basically sound and no radical changes are called for. A few States have, however, observed that the existing arrangements have not worked well and substantial changes are necessary. Some State Governments have pointed out that the scheme of the Constitution is marked by a trend towards over-centralisation in regard to both policy and administration. Further, the States should be able to command means of meeting their wants in the same way as the Union Government possesses the means in respect of its wants.

10.3.09 We have already noted that the Constitution envisages clearly demarcated areas of taxation for the Union and the States. These have been enumerated in List I and List II of the Seventh Schedule. Generally, the States have stated that there is no need to make any changes in the division of the areas of taxation envisaged in the Constitution. In fact, one State has pointed out that any transfer of taxation fields now with the Union to the States would make the rich States richer and the poor States poorer. The Union Ministry of Finance also holds that the 'Present system has a sound rational basis and may not require any alteration'.

10.3.10 On the other hand, some State Governments are of the view that their fiscal powers should be enlarged. Some specific suggestions have been made to empower the States to levy taxes and duties including those enumerated in Articles 268 and 269 as well as to remove some of the restrictions on States' taxation powers. It has also been suggested that States may be enabled to levy any taxes not mentioned in List I and List II of the Seventh Schedule. It has been further suggested that the Union Government should voluntarily withdraw from excise duties on certain commodities and give up additional excise duties now imposed on certain commodities in lieu of Sales Tax. It has also been suggested by a State Government that the Union should voluntarily abstain from levying Excise Duties on certain commodities leaving the State Governments free to levy Additional Sales Tax on these commodities to an equivalent extent. Another State Government has suggested that the States should be given the powers to levy excise duty on medicinal and toilet preparations containing alcohol, tax on futures markets, etc. Yet another State Government has proposed that the proceeds of Income Tax and Union Excise Duties should be made mandatorily assignable to the States in full although, for the sake of uniformity, they may continue to be collected by the Union.

10.3.11 A State Government has suggested that the States may also be permitted to levy Corporation Tax on companies whose factories are situated in the respective States, which would imply concurrent taxation in this field.

ISSUES IN OPERATION OF THE SCHEME - CORPORATION TAX

10.3.12 State Governments have criticised the policy of the Union Government to keep out of the divisible pool certain resources which, according to them, should have been shared with them. An important instance of this, the States allege, is the exclusion of Corporation Tax from the divisible pool by an amendment of Income Tax Act in 1959. A number of State Governments and some political parties have suggested that the proceeds of Corporation Tax should be made sharable with the States.

SURCHARGE ON INCOME TAX

10.3.13 The States have complained that the long continuance of Surcharge on Income Tax (given up only in 1985-86) deprived them of considerable revenue which would have been sharable with the States if only Government of India had, instead, adjusted the basic rates of Income Tax. Some States, an all-India political party and several others have suggested that the proceeds from Surcharge on Income Tax should be made sharable with the States.

OTHER BASIC EXCISE DUTIES

10.3.14 Revenues from Union Excise Duties (Basic duties), levied under Article 272, are being shared on the recommendations of the Finance Commission. It is alleged that the Union Government has levied separate excise duties on commodities (e.g., special, regulatory and auxiliary excise duties on some commodities) thus keeping these revenues outside the purview of sharing.

CONCESSIONS/REBATES ON INCOME TAX

10.3.15 Some of the States have alleged that the Union Government has not been showing sufficient interest in raising revenues from Income Tax, 85 per cent of which is now sharable with the States. On the other hand, through the Special Bearer Bonds Scheme, the Union Government mobilised resources for its exclusive use which would have been otherwise shared by the States, if better compliance of Income Tax Act had been enforced.

ADMINISTERED PRICES

10.3.16 Many States have complained against the increases in administered prices, e.g., of petroleum and coal, unilaterally made by the Union instead of increasing excise duties, which would have been sharable with them.

CURBS ON STATES' SALES TAX

10.3.17 Several State Governments have drawn attention to the changes introduced by the Constitution (Sixth Amendment) Act, 1956 in Articles 269 and 286 and by the enactment of the Central Sales Tax Act, 1956. They allege that these amendments have adversely affected the yield from States' Sales Tax which is the most important source of revenue to them. The modified Article 269 read with the new Entry 92A, empowers Parliament to levy tax on sale or purchase of goods in the course of inter-State trade but makes its proceeds assignable to the States. Article 286 as modified by the Sixth and forty-Sixth Amendment Acts takes away the power of the States to levy tax on essential goods by authorising Parliament to impose restrictions by law on the States to impose tax on sale or purchase of goods declared by Parliament to be of special importance in inter-State trade and commerce.

10.3.18 One political party has asked for deletion of Entries 92A and 92B from List I and their transfer to the State List. It has also suggested modification of clauses (3)(a) and (b) of Article 286 and removal of limitations imposed on the power of the States to levy tax on the sale or purchase of goods imposed under Article 286 read with Article 269 and Entry 92A of List I.

PROPERTY TAXATION

10.3.19 Some of the States have pointed out that in view of the provisions of Article 285(2), read along with Section 154 of the Government of India Act, 1935, the municipal bodies in the States cannot levy tax on properties of the Union Government which came into being after 1-4-1937, nor are the States' local bodies allowed to enhance the old rates. Similarly, the Railway properties are protected by Section 135 of the Indian Railways Act, 1890 read with Section 4 of the Railways (Local Authorities Taxation) Act, 1941, which permit only such taxation as is allowed by the Government of India. Because of these provisions the local bodies of the States are losing revenue whereas they are required to provide services to the Union Government and Railway establishments.

SCHEME OF ADDITIONAL EXCISE DUTY

10.3.20 Some of the States have complained that replacement of Sales Tax by Additional Duties of Excise (Goods of Special Importance) Act, 1957 which covered sugar, tobacco and textiles resulted in loss of revenue to them. Although the yield from the Additional Excise Duties is assigned to the States, the revenue raised from them is allegedly not as high as what could have been realised had the Sales Tax on them continued. A few State Governments have suggested withdrawal of this scheme to enable the States to levy Sales Tax on these commodities.

GRANT IN LIEU OF RAILWAY PASSENGER FARES TAX

10.3.21 Most of the State Governments have drawn attention to the fact that the grant in lieu of the Tax on Railway Passenger Fares, which was abolished in 1961, has been far less than what they would have realised had the tax measure been continued, owing to the growth in revenue from railway fares. A few States and an all-India political party have demanded re-imposition of the tax on the Railway passenger fares.

ROYALTY RATES

10.3.22 Two States which have resources of petroleum and natural gas, have demanded revision of royalty corresponding to the increase in the prices of these items. Similar demands have been made in respect of minerals by other States.

PAY/D.A. REVISIONS

10.3.23 Union Government's decisions on pay revision, terminal benefits, granting instalments of dearness allowance, etc., are said to cast a corresponding burden on the States. This is cited as an instance where actions of the Union result in additional expenditure to the States. A few State Governments have stated that this additional burden should be shared by the Union.

ARTICLES 268 AND 269

10.3.24 Some States have pointed out that the failure of the Union Government to mobilise sufficient revenue under Articles 268 and 269 has adversely affected their interests. A few States have suggested that the powers to levy some taxes and duties included in these Articles may be transferred to the States. An all-India political party has suggested that through constitutional amendment levying of taxes and duties included in Article 269 should be made compulsory.

TRANSFERS UNDER FINANCE COMMISSION *VIS-A-VIS* OTHER TRANSFERS

10.3.25 Closely related to the issue of vertical imbalance is the alleged inadequacy of the mechanism provided in the Constitution to rectify the same. Almost all the State Governments have pointed out that resource transfers outside the channel of the Finance Commission, have increased year after year and now overshadow the statutory transfers.

FINANCE COMMISSION

10.3.26 Another complaint is that in determining the composition of the Finance Commission and laying down its terms of reference, the States are not taken into confidence. Further, by listing certain considerations which the Finance Commission might, *inter alia,* keep in view in recommending grants-in-aid of revenue to the States, the Finance Commission has been 'shackled'.

10.3.27 Some State Governments are of the view that the recommendations of the Finance Commission should be implemented *in toto.* The non-implementation of the final recommendations of the Eighth Finance Commission in full, has added yet another dimension to the problems in financial relations between the Union and the States.

10.3.28 Several State Governments have criticised the so-called 'gap-filling' approach of the Finance Commission in determining the quantum of Central transfers.

(10.3.29 to 10.3.36 not inserted).

NATURAL CALAMITIES

10.3.37 There are complaints of delay, inadequacy and even discrimination in providing relief for major calamities which need to be dealt with as a matter of national concern.

UNION EXPENDITURE ON STATES' SUBJECTS

10.3.38 It has been pointed out by some of the States that the Union Government incurs substantial expenditure on several subjects, belonging to the sphere of the States (e.g., agriculture, rural development, cooperation, health and irrigation) through the Centrally Sponsored Schemes and by maintaining large establishments. These have, on the one hand, allegedly deprived the States of substantial transferable revenues and, on the other, distorted their priorities by requiring them to find matching funds for the schemes sponsored by the Union Government.

EXPENDITURE CONTROL

10.3.39 Most of the State Governments feel that the functioning of the existing institutions - Comptroller and Auditor General and the Public Accounts Committees of the Parliament and State Legislatures - should be strengthened for improving expenditure control. A State Government has, however, complained that the present centralisation of audit results in procedural delays. It is pointed out that accounts are finalised with gaps of three to four years. In this connection, it has drawn attention to Section 167 of the Government of India Act, 1935 which empowered a Provincial Legislature to create the office of an Auditor-General. Another State Government has stated that considering the desirability of evaluation audit, it should be entrusted to an agency constituted by the State Government itself.

EXPENDITURE COMMISSION

10.3.40 Many States have emphasised that there is need for a thorough examination of the Union Government's expenditure since this has implications for resources available for transfer to the States. Some have suggested that this should be done by an Expenditure Commission as the existing mechanisms are inadequate for this purpose.

INSTITUTIONAL FINANCE

10.3.41 Union Governments' exclusive control over the policies and resources of the Banks and the Public Sector financial institutions is also one of the irritants in Union-State financial relations, although these are Union subjects. The fact that more than half of the loans from the public sector financial institutions have gone only to two States, has been adversely commented upon. In this connection, some suggestions have been made for setting up a National Credit Council having representatives of the State Governments on its panel.

FINANCIAL INDISCIPLINE

10.3.42 The Union Government has, on the other hand, drawn attention to the considerable increase in transfer of resources to the States over the years, particularly during the last three Plan periods. The demand of the States for financial assistance to deal with natural calamities has expanded 3 to 4 times in recent years, showing inadequate financial control and discipline.

10.3.43 The issues in Union-State financial relations revolve round the States' case for having access to more resources in a situation of overall resource shortage. Interlinked are the problems regarding the patterns and modes of Central transfers, relative revenue mobilisation efforts, prudence in incurring expenditure, sharing of the community's savings, deficit financing, etc. There is demand for greater objectivity and automaticity in resource transfers and allocations.

4. FACTUAL REVIEW

10.4.01 We have in the preceding Section noted the criticism and the main issues. In order to examine them, it is necessary to look into the broad trends in respect of the major areas of resource mobilisation and transfers. This has been attempted in this Section.

GROWTH IN RESOURCES

10.4.02 The basic data in regard to growth of revenues of the Union and the States and trends in actual sharing or resources by them is set out in Annexure X.2 (Not inserted). The trend rates of growth[5] in revenues of the Union and State Governments covering the period 1951-52 to 1984-85 are given in the following table:

5 Obtained by fitting the function, $y = a.b^t$ where, y = revenue; a = constant; b = 1 + (r/100); t = time; and r = growth rate.

Annual Percentage Trend Rates of Growth in the Combined Resources of the Union and the States, 1951-52 to 1984-85

Item	Revenue Account	Capital Account	Total
(1)	(2)	(3)	(4)
I. Resources:			
Combined Union	13.43	11.49	12.80
(i) Before transfers to the States	13.76	11.51	12.89
(ii) After transfers to the States	13.05	12.03	12.58
States			
(i) 'Own' revenues	12.86	11.76	12.67
(ii) Total revenues (including transfers)	13.74	10.77	13.04
II. Transfers to States	15.60	10.30	13.67

10.4.03 During the 34 years, 1951-52 to 1984-85, the resources of the Union and State Governments registered a very significant increase. It is seen from the above table that the resources of the States are not less elastic than those of the Union.

10.4.04 The Union Government has been raising bulk of the financial resources. Of the combined aggregate resources during the period 1951-85, Union Government raised 71.5 per cent and States 28.5 per cent resources. Before transfers, during the First Plan period, the resources raised by the Union were Rs 4,495 crore. They increased to Rs 1,74,756 crore in the Sixth Plan period. Correspondingly, the aggregate resources of the States, before transfers from the Union, were Rs 2,241 crore in the First Five Year-Plan period and they increased to Rs 69,640 crore during the Sixth Plan period. The resources raised by the States as a percentage of the combined resources have shown a decline from 33.3 per cent in the First Plan period to 28.5 per cent in the Sixth Plan period (Annexure X.2) (Not inserted).

10.4.05 Yields from individual taxes of both the Union and the States, have shown large variations in growth during the period 1951-85. Their relative importance in some cases has also changed significantly as would be evident from the following table:

	1951-52		1984-85	
	Rs in Crore	Percentage Share in Total Tax Revenue of Union/States	Rs in Crore	Percentage Share in Total Tax Revenue of Union/States
(1)	(2)	(3)	(4)	(5)
I. Union Taxes:				
1. Income tax*	145.99	28.5	1,927.66	8.2
2. Corporation Tax	41.41	8.1	2,555.90	10.9
3. Union Excise Duties*	85.78	16.7	11,150.84	47.5
4. Customs Duty	231.69	45.2	7,040.52	30.0
All Union Taxes	512.65	100.0	23,470.59	100.0
II. State Taxes:				
1. Land Revenue, etc.	48.87	21.3	318.41	2.6
2. Sales Taxes	59.04	25.8	7,028.94	56.9
3. State Excise Duties	50.14	21.9	1,857.36	15.0
4. Motor Vehicles' Tax	9.89	4.3	704.55	5.7
5. Entertainment Tax	8.94	3.9	360.07	2.9
All States' Taxes	229.05	100.0	12,342.81	100.0

* Before transfer of States' share.

Source: Ministry of Finance: *Indian Economic Statistics-Public Finance*, 1959 and 1986.

10.4.06 It is pertinent to note that at the time of framing of the Constitution, when Income Tax was made compulsorily sharable, it was, apart from Customs Duty, the most important source of revenue to the Union. Its share in the aggregate tax revenue of Government of India stood at 28.5 per cent in 1951-52 but has come down to 8.2 per cent in 1984-85. Excise and Customs Duties, having 47.5 per cent share and 30 per cent share, respectively, in 1984-85, are now the most important taxes of the Union.

10.4.07 The structure of tax receipts of the States has also undergone significant changes during this period. Land Revenue (21.3 per cent share in 1951-52 in States' own tax revenues) has now become insignificant (2.6 per cent share) as compared to the receipts from Sales Tax and State Excise Duties (56.9 per cent and 15.0 per cent shares, respectively).

10.4.08 State taxes have shown widely different growth rates. Some, like Land Revenue, have hardly grown. But the important taxes like Sales Tax, State Excise Duties and Entertainment Tax, have shown considerable buoyancy. The growth rate in States' own tax revenue has been significant and, indeed, somewhat higher than that of the Union. This discounts the general impression that the sources of revenue allotted to them are less elastic compared to those of the Union. This is also in conformity with the findings of some studies which have observed that the States' resources have grown in tandem with those of the Union.[6] This is evident from the following table giving compound annual growth rates in all-tax revenues and in those of selected taxes of the Union and the States, before any transfers from the Union to the States, for the period 1974-75 to 1984-85:

Union Taxes	Percentage Compound Annual Growth Rate, 1974-75 to 1984-85	States' Taxes	Percentage Compound Annual Growth Rate, 1974-75 to 1984-85
(1)	(2)	(3)	(4)
All Taxes	14.0	*All Taxes*	15.5
Income Tax	8.2	Land Revenue, etc.	7.9
Corporation Tax	13.7	Sales Taxes	16.6
Customs Duty	18.1	Motor Vehicles Tax	14.8
Union Excise Duties	13.2	State Excise Duties	16.8
		Entertainment Tax	12.2

10.4.09 It is noteworthy that a State Government has also highlighted the fact that the States' aggregate tax revenue is fairly elastic to prices and incomes. According to it, any disadvantage that the States might have relatively to the Union, in this respect, is of only minor and not crucial significance.

TRANSFERS FROM THE UNION AND THEIR GROWTH

10.4.10 An analysis of data relating to resource transfers to the States from the Union reveals certain interesting facts. On revenue account, prior to transfers to States, the Union Government's share has been stable around two-thirds of the combined revenue resources of the Union and the States. On capital account, its share was 85.4 per cent during the period 1951-85 and that of States 'own' resources 14.6 per cent[7] (Annexure X.2) (Not inserted).

10.4.11 Transfer of total resources during the period 1951-85 from the Union to the States has been substantial, being 22.6 per cent of the combined aggregate resources. As a percentage of the total resources raised by the Union, the transfers to the States accounted for 31.6 per cent. As a result of these transfers the resources of the States became a little over half of the combined resources of the Union and the States. Transfers to the States during the period 1951-85 have increased from Rs 1,307 crore during the First

6 See, for example, Wallich, Christine - *State Finances in India, Vol. I - Revenue Sharing*, World Bank Staff Working Papers, No. 523 (1982), p. 22, Econometric studies by the National Institute of Public Finance and Policy and others have also estimated high elasticity and buoyancy in State Taxes.
7 This is on the basis of net sharing of resources, i.e., as they are actually available for financing respective expenditures. However, if the amounts of repayment by the States on Central loans are added back to them, as has been done by some studies, their share will be a little over one-fifth.

Plan period (1951-56) to Rs 56,031 crore during Sixth Plan period (1980-85) showing an annual trend growth rate of 13.67 per cent. This brings out the significant role of the resource transfers to the States (Annexure X.2) (Not inserted).

REVENUE AND CAPITAL TRANSFERS

10.4.12 Further break-up of the transfers in terms of revenue and capital shows that on revenue account, the transfers to the States have been approximately three-fourths of the total transfers (Annexure X.2) (Not inserted). In the initial years (1951-56) the transfers on revenue account were about 46 per cent. Thus, the revenue account transfers have not only shown volume growth but also as a percentage of the total transfers they have risen steadily from 46 per cent to 73 per cent. The trend growth rate of transfers on revenue account works out to 15.60 per cent per annum (Annexure X.3) (Not inserted).

STATES' SHARE IN COMBINED RESOURCES OF THE UNION AND THE STATES

10.4.13 After taking into account the transfer of resources from the Union to the States, the percentage share of the States in combined aggregate resources has remained around 50 per cent. Their shares since the First five Year Plan in the combined aggregate resources and separately on revenue and capital accounts, have been as under:

(Percentages)

	Revenue	Capital	Total
1951-56	54.0	50.0	52.7
1956-61	57.3	31.2	46.3
1961-66	49.3	38.8	45.7
1966-69	54.2	37.1	48.7
1969-74	56.1	46.2	53.8
1974-78	54.0	35.9	50.0
1978-80	58.2	41.2	53.9
1980-85	59.3	32.7	51.4
1951-85	57.2	35.9	51.2

This is in so far as the direct sharing of resources is concerned. In addition, the Union Government incurs considerable expenditure through subsidies, Central plan investment and on other items which benefit the States and indirectly reduce pressure on their expenditure.

PATTERN OF TRANSFERS

10.4.14 It will also be pertinent to consider the pattern of transfers. Resources are transferred partly on the recommendations of the Finance Commission, partly through the Planning Commission and also directly from the various Ministries of the Union Government. We have considered in detail the pattern of devolution in Section 7 and the salient features are noted below.

10.4.15 The transfers on account of the Finance Commission have gone up from 31.2 per cent in the First Five-Year Plan period to 41.3 per cent in the Sixth Plan period (Annexure X.4) (Not inserted). Transfers on the recommendations of the Planning commission show considerable fluctuations during this period. During the last two Five-Year Plan periods, they were around 42 to 43 per cent. These transfers include those on account of Central and Centrally Sponsored Schemes. These were only 2.8 per cent during the period 1966-69 (i.e., after the Third Plan) and have gone up to over 11 per cent in the Sixth Plan Period. During the last two plans, 'other transfers' were 15.0 and 15.3 per cent, respectively.

10.4.16 Another interesting aspect of these transfers is seen in the split between Revenue and Capital components. Transfers through the Finance Commission have been almost wholly on revenue account. Out of these revenue transfers, 85.1 per cent were by way of tax-sharing and the remaining 14.9 per cent were in the nature of grants or sharing of other resources for the period 1952-84 (see Annexure X.5) (Not inserted). On the other hand, Plan transfers carry a large loan component.

TRENDS IN UNION FINANCES

10.4.17 Looking at the pattern of non-plan expenditure of the Union, it is seen that a large part of it is on defence, interest payments and subsidies. These three items which constituted 65.1 per cent of the total non-plan expenditure in 1970-71 have risen steadily to 73.3 per cent in 1987-88 (B.E.)

10.4.18 Since 1979-80 the Budgets of the Union Government have persistently shown deficits on the revenue account. The Balance from Current Revenues became negative for the first time in 1985-86. We have dealt with these matters in greater detail in Section 7 subsequently.

NEED FOR IMPROVING RESOURCE MOBILISATION AND MANAGEMENT

10.4.19 There is still considerable scope for both the Union and the States to step up revenue mobilisation. The Long Term Fiscal Policy document of the Union Government clearly recognises the need to increase the Balance from Current Revenues so as to reduce the dependence on substantial internal borrowing for financing the Plan. Internal borrowings have of late gone up sharply, resulting in large interest payments. Further, as many as 90 non-departmental undertakings of the Union Government incurred a loss of Rs 1,656.34 crore in 1985-86.[8] The funding of the Seventh Five-Year (Central Sector) Plan crucially depends on the generation of sufficient surpluses by the Union Public Sector Undertakings.

10.4.20 Similarly, over the years most of the States have given exemptions on Land Revenue, etc., whereas the gross value and volume of agricultural production have increased manifold during this period. Only a few States are at present levying Agricultural Income Tax and that too, to an insignificant extent (total receipts Rs 91.33 crore in 1984-85). Wide State-wise variation in the effective rates of taxation in relation to the relevant bases is also indicative of the considerable potential yet to be tapped for revenue mobilisation.[9] Agricultural income taxation is not easy to administer and not amenable to easy solution in respect of its assessment and collection. Further, large commercial losses are reported to have been incurred by States' public sector enterprises - State Electricity Boards (Rs 1,123 crore in 1984-85), State Road Transport Corporations (Rs 150-200 crore in each year of the Sixth Plan period) and commercial irrigation systems (Rs 592 crore in 1984-85).[10] With these losses in the Centre and in the States, the regimen laid down by the Finance Commission for the Public Sector has been frequently violated and the hopes expressed by the Planning Commission in the Five Year Plan have been belied, notwithstanding the approval of the National Development Council. It has been observed by one State Government that 'policies and measures to improve the financial performance of States' departmental and non-departmental undertakings must be an important element of the required many-sided efforts towards establishing more even financial balance between the Centre and the States. The resulting improvement in the return on investment and enterprise secured by the States would make a sizeable contribution to reducing the gap between their revenue expenditure and own tax and non-tax revenues'. We are in full agreement with this observation.

10.4.21 One State Government has complained that the Union-State financial relations 'grievously violate the basic principle of federal finance that each level of government must be substantially, if not wholly, self-reliant with regard to financial resources required for the due discharge of its responsibilities'. On an analysis and comparison of the aggregate figures of expenditure and the revenues of all the States relating to the financial years 1983-84, 1984-85 and 1985-86, it maintains that the States' dependence on resource transfers from the Union for financing their revenue expenditure is now close to 40 per cent and for financing their capital expenditure is much greater than this percentage.

10.4.22 On the basis of a study of the growth in the respective revenues of the Union and the States over the period 1975-76 to 1985-86, it holds that the indirect taxes of the States in comparison with those of the Union, are equally, if not more, elastic, to prices and income. It rejects

8 Government of India, Bureau of Public Enterprises - *Public Enterprises Survey, 1985-86,* p. 10.
9 Please refer to Chelliah, Raja J. and Sinha, Narain - *State Finances in India, Vol. 3, - The Measurement of Tax Effort of State Governments, 1973-76,* World Bank Staff Working Papers, No. 523, (1982).
10 Government of India, Ministry of Finance - *Economic Survey, 1985-86,* p. 75.

the oft-trotted argument that this dependence of the States on the Union for financing their revenue expenditure, is due to the overall inelasticity of the States' own taxes. After further discussion, it propounds the thesis that the 'crucial factor for States' financial dependence on the Centre is their very narrow tax base in relation to their revenue expenditure as well as the Centre's tax base'. This State Government has also noted 'that the States' non-tax revenue contributed by their departmental and non-departmental undertakings has deteriorated over the years'.

10.4.23 The difference between States' own revenues and their revenue expenditures over a period of years, is not an infallible measure of the extent of their dependence on the resource transfers from the Union. The main snag is that the quantum of the revenue expenditure of a State carries a substantial component relatable to revenue received by transfer from the Union. This component is a variable factor which has an incremental effect on the level of the States' revenue expenditure. The alleged 'narrow tax-base of the States', therefore, cannot be related quantitatively to the level of their revenue expenditure as the latter itself depends upon their total revenue resources including revenue transfers from the Union. Nor can it be appropriately related to the Union. Governments' tax-base as the Union expenditure obligations as well as transfer of revenues to the States, are on a different footing. For analysing the issues in question, it will be pertinent to distinguish between States' indirect and direct taxes. The State Government mentioned above, has candidly conceded after a quantitative analysis, that the States' indirect taxes (Sales Tax, State Excise Duties, Taxes on Motor Vehicles, Entertainment Tax, Taxes on Passengers and Goods, Electricity Duty and Stamp Duties and Registration Fees) are fairly elastic to prices and income but their direct taxes, such as Land Revenue and Profession Tax, are highly inelastic.

10.4.24 The indirect tax structure of the States is quite board-based (broad-based). The States' financial performance in respect of direct taxes relating to the agricultural sector, viz., Land Revenue, Agricultural Income Tax, returns on commercial irrigation, etc., however, is poor. Most of the States have partially given up Land Revenue. The Agricultural Income Tax, as discussed subsequently in paragraphs 10.5.67 to 10.5.72 is beset with complicated problems.

10.4.25 In line with this analysis, it would be advantageous at this stage to take note of the broad trends in other federations. Due to great diversity of political systems and lack of full information, it is not possible to make accurate international comparisons of revenue centralisation and expenditure decentralisation. Nonetheless, it can be said without fear of contradiction that generally all over the world the federal governments have a large and increasing control over revenues. This is particularly true of Australia and to a large extent of the United States of America. A more balanced situation exists in Canada and West Germany. A comparative study held under the auspices of National Institute of Public Finance and Policy has observed:

> We may conclude that there is slightly higher degree of centralisation of revenues in India than is generally found in the economically developed federations. But the expenditure decentralisation in India is greater than in those federations. As a result, the degree of dependence on the Centre, in terms of the share of federal transfers in States' revenue, is higher. However, in so far as the transfers take place in the form of constitutionally assigned taxes, the high share of federal transfers cannot be said to be an indicator of dependence.[11]

Our studies show that the increasing quantum of the constitutionally assured revenue transfers to the States substantially reduces their initial dependence on the Union for revenue expenditure.

10.4.26 The factual review carried out in the preceding paragraphs brings out three important conclusions. They are:

11 *Trends and Issues in Indian Federal Finance* (1982), p. 6.

(1) The Union has been raising the major part of the combined resources;
(2) The growth-rate in States' own revenues, given the initial small base, has kept pace with that of the Union; and
(3) Transfers to the States have grown significantly over the years.

10.4.27 At this stage it would be advantageous to deal with the general issue noticed in para 10.3.02 that the large dependence of the State on the Union is indicative of a weakness in the existing arrangements. We have earlier noted that the division of the heads of taxation between the Union and the States envisaged in the Constitution follows certain basic principles according to which those taxes which require a uniform treatment and/or have inter-State significance are with the Union. As a result, the major and expanding sources of revenue are with the Union. In recognition of this situation, the constitutional scheme has provided for sharing of revenues raised by the Union and mechanisms for their transfer from the Union to the States. Therefore the mere fact that a considerable gap exists between the requirements and 'own' resources of the States need not *per se* be regarded as a short-coming in the present system. The real issues for consideration are

(i) whether it is possible to enlarge the 'own' resources of the States by transferring more powers of taxation to them;
(ii) should the size of the sharable pool be increased; and
(iii) whether the existing mechanisms for transfer of resources from the Union to the States are adequate.

We have considered these issues in the ensuing Sections.

10.4.28 Before concluding, it is necessary to take note that apart from the above, on the methodological plane, a difference between expenditure incurred by the States and their 'own' resources is not an infallible indicator of a genuine gap between them. The problem is not so simple and bristles with several complications. It involves an objective assessment of the fiscal needs, tax efforts, tax potential of the States and efficiency of fiscal management. Quantification of all these factors is extremely difficult, if not impossible. Further, the level of expenditure of the States is itself determined by transfers from the Union, besides their own resources. It cannot, therefore, be taken as a sure measure of their needs. The determination of gaps in resources *vis-a-vis* the fiscal needs of the States is thus not amenable to any simple analysis.

5. ENLARGEMENT OF STATES' RESOURCES

ALTERNATIVES

10.5.01 In our Questionnaire, we had invited suggestions on how the States' resources could be augmented. The possible alternatives put forth to elicit replies comprised any one or a combination of the following:

(a) Complete separation of the fiscal relations of the Union and the States, abolition of the scheme of transfer of resources and instead, transferring more taxing heads to List II, Seventh Schedule.
(b) Transfer of a few more elastic taxation heads to List II.
(c) All the taxing heads/taxing powers be transferred to the Union List to form a sharable pool, the respective shares of the Union and the States as a whole being specified in the Constitution itself, the amounts and the principles on which the States' share would be distributed amongst the various States, be determined by the Finance Commission.
(d) More Central taxes such as Corporation Tax Customs Duty, Surcharge on Income Tax, etc., be brought into the sharable pool.
(e) Financial resources, other than tax-revenues of the Union, be also distributed between the Centre and the States.

10.5.02 None of the State Governments or experts has favoured alternatives (a) and (c). As regards transfer of a few more elastic taxation heads to the States, most State Governments have not suggested any change in the division of taxation subjects as enumerated in the Seventh Schedule of the Constitution. As stated in Section 3, some of the States have suggested enlargement of States' tax-base by transferring more taxation powers to them, if necessary, by amending the Constitution. Even they do not suggest transfer of any of the more important heads of taxation, like Union Excise Duties and Customs Duties, from the Union List to the State List.

10.5.03 However, one State Government has suggested that with a view to widening substantially the States' tax-base, the Union should abstain from levying Excise Duty on certain products (present yield roughly 40 per cent of the total Union Excise revenue) and allow the States to levy Additional Sales Tax for an equivalent amount on them in lieu thereof. Further, States may also be allowed to levy Surcharge on the Additional Sales Tax, if needed. It has been suggested that such selected commodities should be the industrial products on which Sales Tax cannot be easily avoided, viz., petroleum products, tyres, processed vegetable oils, vanaspati, cement, iron and steel and products thereof, sheet glass, T.V. sets, and motor vehicles and tractors.

10.5.04 At the outset, we will consider the suggestion regarding levy of Additional Sales Tax in lieu of Union Excise Duty on certain commodities. At present, 40 per cent of the net proceeds from Union Excise Duty is already being transferred to all the States and another five per cent to the revenue-deficit States as per recommendations of the Eighth Finance Commission. The above-mentioned proposal will put the poorer States with low levels of consumption and corresponding lower capacity to raise revenue in this manner to serious disadvantage. Further, the implications of the proposal involve a very substantial revenue loss to the Union in addition to the present scale of transfers, and will thus drastically cut into Union's resources. Moreover, inasmuch as some of the products mentioned in the proposal are either essential commodities and/or important industrial inputs, significant inter-State differentials in their prices may create serious problems.

In view of the above considerations, we are unable to agree to this proposal.

ENLARGEMENT OF STATES' TAXATION POWERS

10.5.05 These suggestions fall broadly into three groups. Firstly, those relating to the taxes and duties included in Articles 268 and 269; secondly, those relating to transfer of residuary powers of taxation to the States, and thirdly, those which aim at removing or relaxing the limitations on the powers of the States to raise resources including transfer of powers of taxation in regard to certain commodities to them.

10.5.06 We have considered the above-mentioned suggestions in the chapter on Legislative Relations mainly from the view-point of constitutional implications. Here, the focus would be on the functional implications of these suggestions.

DUTIES UNDER ARTICLE 268

10.5.07 Article 268 lays down that such stamp duties and such duties of excise on medicinal and toilet preparations as are mentioned in the Union List shall be levied by the Union but collected and appropriated by the States. These duties are referable to Entries 84[12] and 91[13] of the Union List

12 '84. Duties of excise on tobacco and other goods manufactured or produced in India except -
(a) alcoholic liquors for human consumption;
(b) opium, Indian hemp and other narcotic drugs and narcotics;
but including medicinal and toilet preparations containing alcohol of any substance included in sub-paragraph (b) of this entry'.

13 '91. Rates of stamp duty in respect of bills of exchange, cheques, promissory notes, bills of lading, letters of credit, policies of insurance, transfer of shares, debentures, proxies and receipts'.

with corresponding qualification of Entry 51[14] of State List. The Medicinal and Toilet Preparations (Excise Duties) Act, 1899 governs the levy of these duties.

10.5.08 It has been suggested by a State Government that the power to levy the duties mentioned in Article 268 may be transferred to the States and for that purpose, Entries 84 and 91 may be transposed to the State List and corresponding changes made in the provisions of Article 268. It is argued that these duties do not form part of inter-State transactions 'to any large extent'. Further, the differential rates which might arise if States are given powers to levy these duties will not affect the optimum utilisation of sources in any way. A general principle enunciated by this State Government in support of its suggestion is that the efficiency in taxation is highest when the tax is administered and collected by the same authority which has the power to appropriate it. The thrust of the argument is that for augmenting the inadequate resources of the States, it would be desirable to empower them to levy these duties.

10.5.09 Entry 84 comprehends, among other things, a range of medicinal items which are important from the view-point of public health policy. In the Government of India Act, 1935, the subject was, however, included in the Provincial List (Item 40). The framers of the Constitution, while transferring this head to the Union List, noted that it was not then being significantly exploited for raising revenue by the Provinces. Moreover, they felt the necessity of an all-India Drugs Policy.[15]

10.5.10 In furtherance of the constitutional Directive Principles of State Policy in Article 47, the primary objective of the tax-laws should be to regulate and control the production of these intoxicants and preparations on a uniform basis, and revenue earning should be a secondary purpose. The Union Ministry of Finance has also emphasised this aspect in the information supplied to us. The items covered by this Entry have inter-State aspects. Uniformity even in regard to the principles of their taxation is desirable in the larger national interest.

10.5.11 So far as stamp duties under Entry 91 (List I) are concerned, the desirability of uniform rates throughout the country in commercial and related transactions (involving bills of exchange, cheques, promissory notes, bills of lading, letters of credit, life insurance policies, general insurance policies, transfers of shares, debentures, proxies and receipts) is self-evident. Inter-State disparities in their rates and tax-regulations can play havoc with commercial activity and free flow of trade. We are, therefore, of the view that no change in the present position and content of Entries 84 and 91 of List I is called for.

10.5.12 Some State Governments have pointed out that all the duties mentioned in Article 268 should be better exploited. The scope for raising revenue from these duties was examined for the first time recently by the Eighth Finance Commission. It noted that inasmuch as the duties of excise on medicinal and toilet preparations were raised only in 1982, there was not much scope for a further increase then. Some scope for raising stamp duties on bills of lading (excluding those in respect of inland navigation, letters of credit and policies of general insurance) was considered feasible, but in the absence of adequate data, the amounts could not be quantified. The Finance Commission, therefore, left the matter to the Union Government for appropriate revisions in rates of duties. We have been informed by the Union Ministry of Finance that the Government 'has already implemented most of these recommendations'. The Ministry has further commented: 'Since the Finance Commission is being

14 '51. Duties of excise on the following goods manufactured or produced in the State and countervailing duties at the same or lower rates on similar goods manufactured or produced elsewhere in India:-

(a) alcoholic liquors for human consumption;

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

but not including medicinal and toilet preparations containing alcohol or any substance included in sub-paragraph (b) of this entry'.

15 See *Constituent Assembly Debates* (New Series) Book 5, September, 1, 1949, page 839 (Statement by Dr. B.R. Ambedkar).

asked to comment on the manner in which these duties could be exploited in the best interests of the States without affecting the national economy, the interests of the States are sufficiently safeguarded by the present procedure'.

10.5.13 Under the present circumstances, duties on all the items covered by Article 268 do not appear to be a buoyant source of revenue amenable to frequent revisions. Since basic circumstances do not always remain constant, we recommend that the Union Government should, in consultation with the State Governments, periodically consider and explore the revisions of these duties. We further recommend that the revenues raised from these duties should be separately specified in the budget and other relevant publications.

TAXES AND DUTIES UNDER ARTICLE 269

10.5.14 Article 269 refers to taxes levied and collected by the Union but assigned to the States. It enlists eight taxes and duties (mentioned in the footnote to para 10.2.16(b) above). These are referable to Entries 87, 88, 89, 90, 92A and 92B of the Union List. Of these, at present, only under Entry 92A, a tax on sale or purchase of goods in the course of inter-State trade and commerce is being levied.

10.5.15 Some State Governments have pointed out that the Union Government has not raised adequate revenues from these heads of taxation. They have suggested that the relevant Entries (specially Entries 87, 88, 89 and 90 of the Union List) may be transferred to the State List.

10.5.16 Entries 87 and 88 of List I:
'87. Estate duty in respect of property other than agricultural land'.
'88. Duties in respect of succession to property other than agricultural land'.

For reasons abstracted in paragraph 10.5.06 above, the same State Government has suggested that 'duties in respect of succession to property other than agricultural land' and 'estate duties in respect of property other than agricultural land', mentioned in Article 269(1) (a) and (b), respectively, 'be delegated to the States for levy'. Somewhat inconsistently with this plea for 'delegation', the State Government has also asked for transfer of the corresponding Entries 87 and 88 of the Union List to the State List.

10.5.17 The incidence of both the taxes, viz., Estate Duty and Succession Duty, is on the same object, viz., property passing on the death of the owner to his successors. But while in the case of the former, value of the whole estate (movable and immovable even if situated in more than one State) would be the base, the succession duty is relatable to the value of individual shares passing on to the successors. In view of this commonalty of incidence, the Fifth and the Eighth Finance Commissions, which had a term of reference to examine the scope for raising revenue from taxes in Article 269, took the position that as Estate Duty was then being levied, it was not worthwhile to levy Succession Duty also. The Economic Administration Reforms Commission, 1981-83 (Chairman: L.K. Jha) had recommended abolition of Estate Duty on the consideration that it had failed in both its objectives, namely, to mitigate the building up of dynastic wealth and raising reasonable resources. It had noted that 96.8 per cent of the assessees in 1980-81 related to the estates whose 'principal value' was less than Rs 3 lakh.[16] In the financial year 1985-86, Estate Duty was abolished in view of its meagre yield (gross collections Rs 22.50 crore in 1984-85).

10.5.18 Although apparently Estate Duty has local base significance, there are several reasons for which it would be desirable to retain it in the Union List if it is re-imposed. An individual may have properties located in more than one State and a total view of his assets can be better taken by the Union Government. Further, if the tax is levied by the States the persons inheriting properties in different States will have to deal with several tax codes and regulations. It is necessary to recognise that taxes like estate/succession duties are not

16 Government of India, Economic Administration Reforms Commission - *Reports on Tax Administration, 1981-83* (p. 33).

expected to be buoyant sources of revenue. If they are levied by the State Governments there is a possibility of unhealthy competition among the States, and consequent bewilderment and embarrassment to the assessees. Uniformity in the main principles of law with respect to these duties is essential in the national interest. Administratively also, it will be far more convenient if this tax is levied and administered by the Union in view of better access to information. Moreover, the net proceeds of Estate Duty till it was abolished were being allocated to and distributed among the States on the basis of formulae recommended by Finance Commission. In view of these considerations we are unable to support the plea that Entries 87 and 88 be shifted from List I to List II.

10.5.19 One State Government has suggested that 'terminal taxes on goods or passengers, carried by railway, sea or air, taxes on sale or purchase of goods which takes place in the course of inter-State trade, etc., be brought under the purview of Article 268'. It has argued that it will be in the interest of tax administration to progressively allow the State Governments to levy and administer these taxes which have now been included in Article 269. One State Government has asked for the transposition of the taxation heads comprised in Entries 89 and 92 of List I to List II. We have dealt with these aspects in detail in the chapter of Legislative Relations.

10.5.20 Entry 89 of List I:
'89. Terminal taxes on goods or passengers, carried by railway, sea or air; taxes on railway fares and freights'.

The above Entry covers taxes listed at (c) and (d) of Article 269(1). While by virtue of this Entry Parliament is empowered to levy 'terminal' taxes on goods and passengers carried by railway, sea or air, the State Legislatures by virtue of Entry 52,[17] List II are competent to impose Octroi (terminal tax) on *entry* of goods into a local area for *consumption, use or sale.* Similarly, under Entry 56[18] of List II, the State Legislatures are competent to levy taxes on goods and passengers carried by road or on inland waterways. A State Government has suggested that the States may be empowered to levy the taxes mentioned in Entry 89 of List I.

10.5.21 One of the most important developments in post-Independence period is the emergence of a vast common market. Transport sector constitutes an important element in the basic infrastructure and its development is vital for the growth of the economy. Uniform rate-structure and policies with respect to them are desirable to ensure that free flow of inter-State trade is not hampered by discriminatory and differential trade barriers raised by the States. Further, the suggestion under consideration carries greater scope for raising revenue by the advanced States with well-organised transport services and would discourage already under-utilised transport in less-developed areas. Finally, in spite of these taxes being within the competence of the Union, in agreement with the Eighth Finance Commission, we do not think that there is much scope for raising revenue from the terminal taxes on goods and passengers.[19] In view of the above considerations, we are of the view that the power to levy terminal taxes on goods and passengers carried by railway, sea or air should remain with the Union Government.

10.5.22 Entry 90, List I:
'90. Taxes other than stamp duty transactions in stock exchanges and futures markets'.

Two State Governments have pointed out that 'futures markets' are essentially intra-State in character dealing with local mercantile and commercial subjects and have suggested transfer of 'futures markets' to the State List. In line with the above argument, they have also suggested that

17 '52. Taxes on the entry of goods into a local area for consumption, use or sale therein'.
18 '56. Taxes on goods and passengers carried by road or inland waterways'.
19 At present a terminal tax is, however, being levied on passengers carried by railway to certain places of pilgrimage or where fairs, *Melas*, exhibitions, etc., are held.

Entry 90, List I (along with Entry 48[20] of List I) be suitably modified by transferring taxes other than stamp duties on transactions in 'futures markets' to the State List.

10.5.23 Futures transactions comprise contracts for sale and purchase of goods at a future date primarily with a view to guarding against adverse price fluctuations. By its very nature futures trading has an organised character and is, in practice, conducted through Commodity Exchanges which frame rules and regulations concerning the contracts. At present, futures trading is allowed at specific centres in respect of four commodities, viz., jute products (sacking bags), paper, turmeric and gur. No tax is currently being levied by Government of India on futures transactions. Indeed, the Fifth and the Eighth Finance Commissions, which considered the scope for raising revenue from taxes included in Article 269, did not find much scope in this tax commensurate with the administrative costs and the difficulties involved.

10.5.24 The futures transactions generally involve operations affecting interests of traders, manufacturers, etc., in more than one State. For example, in the case of 'gur', there are nine major centres where futures trading takes place. If power to tax these transactions is transferred to the States, it may lead to problems in regard to availability of the commodities and prices in other areas of the country. Entry 90 is functionally linked to Entry 48 of List I. We have noted in the chapter on Legislative Relations that stock exchanges and futures markets have an inter-State character. The latter also entails over-seeing development of a broadbased capital market which can be done effectively and uniformly by the Union Government only. In view of these considerations read along with the discussion in the chapter on Legislative Relations, we cannot support the suggestion for transfer of Entry 90 of List I to List II.

20 '48. Stock exchanges and futures markets'.

10.5.25 Entry 92, List I:
'92. Taxes on the sale or purchase of newspapers and on advertisements published therein'.

The State Governments which have suggested the transfer of this Entry to List II, have not given cogent and specific reasons, apart from saying in general terms that such transfer will augment the fiscal resources of the States.

10.5.26 The Union Ministry of Finance has informed us that this tax was placed in the Union List 'to ensure the freedom of the Press, promote the newspaper reading habit and increase the circulation of regional language newspapers'. The scope for raising revenue from this tax was found to be very limited by the Taxation Enquiry Commission (1953) and the Fifth and the Eighth Finance Commission, in view of the still narrow base of newspaper readership and the need to encourage the newspaper reading habit. We have also been given to understand by the Union Ministry of Finance that to encourage the newspaper readership the Union Government 'has even been canvassing the exemption of newsprint from State Sales Taxes'.

10.5.27 A well-informed public opinion is a *sine qua non* of a healthy democratic system. Newspapers play a crucial role in disseminating information, mobilising and focussing public opinion on major issues or concerns of the day. No less significant are the services which newspapers with a large India-wide clientele, render in fostering national outlook and integration. As it is, there is a paucity of newspapers having an India-wide circulation and a sound financial position. If the power to impose this tax is assigned to the States, such newspapers may face cost-differential among States, adversely affecting their circulation and financial viability.

10.5.28 Moreover, under the present arrangements envisaged in Article 269, the net proceeds of this tax, if levied, are to be distributed on the recommendations of the Finance Commission among the States within which it is levied. If the power to levy or collect this tax is transferred to the States, it will be disadvantageous to the less-developed States with low urbanisation and nascent readership.

10.5.29 Since the power to tax has also a potential to destroy, the adoption of a uniform policy which balances the claims of a free viable Press with the need for raising revenue for the States from this meagre albeit dubious source, is essential in the larger interest of the nation as a whole. Only the Union is to do so.

10.5.30 In view of the above considerations, we are unable to support the demand for transfer of Entry 92 of List I to List II.

10.5.31 Entries 92A and 92B, List I:

'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'.

'92B. Taxes on the consignment of goods (whether the consignment is to the person making it or any other person), where such consignment takes place in the course of inter-State trade or commerce'.

A regional political party has suggested that these Entries be omitted from List I, and from Entry 54[21] of List II, the words 'subject to provisions of entry 92A of List I', be deleted.

10.5.32 We have dealt with this matter in the chapter on Legislative Relations under the Section 'Issues regarding Article 286 and related provisions'. We may reiterate here that the broad purpose of the system encompassing Article 286, Entries 92A and 92B of List I and Entry 54 of List II, is to check multiple taxation of the same transaction by different States in the course of inter-State trade and commerce and ensure uniformity in taxation at a relatively lower rate on sale and purchase of certain goods declared to be of special importance. Union Government's overall control in such spheres of taxation to subserve this national purpose is essential. It is also pertinent to note that net proceeds of taxes included in Entries 92A and 92B are entirely for the benefit of the States and are not retained by the Union. In planning the Consignment Tax (Entry 92B) a series of consultations with the State Governments have already taken place. It would, indeed, be desirable that from time to time the Union Government takes the State Governments into confidence in organising all the taxes coming under Article 269. In view of the above-mentioned position, no change in respect of Entries 92A and 92B is called for.

TAXATION OF PROPERTIES

10.5.33 Entry 32, List I:

'32 Property of the Union and the revenue therefrom, but as regards property situated in a State, subject to legislation by the State, save in so far as Parliament by law otherwise provides'.

Articles 285 and 289 provide immunity from taxation of the properties of the Union and the State Governments by the other. A State Government has suggested deletion of the provision 'save in so far as Parliament by law otherwise provides' in Entry 32 of List I as well as in Article 285. It has pointed out that on account of this limitation, local bodies in the States are foregoing substantial revenues. Another State Government has suggested omission of clauses (2) and (3) of Article 289 as they allegedly discriminate against the States inasmuch as Article 285 does not have clauses analogous to these. On the other hand, it has been represented by a Union Government's Corporation that it should also be exempted from taxation under Article 285.

10.5.34 We have examined at length the rationale of the relevant provisions of Articles 285 and 289 in the chapter on Legislative Relations. Briefly, we have noted therein that the immunities apply to direct taxes on property of the Union in a case falling under Article 285 and to direct taxes on income and property of the States under Article 289. There is no immunity in regard to taxes, such as Customs Duties, in relation to property. Similarly, the Union Government also has to pay

21 '54. Taxes on the sale and purchase of goods, other than newspapers, subject to the provisions of entry 92A of List I'.

Sales Tax. A necessary precondition for the harmonious working of a two-tier polity is that neither the national nor the regional government should have powers to make laws which are direct against each other. Properties of the Union Government's Corporations are not on the same footing as the properties of the Union Government. Tax immunities cannot be extended to them. In view of the above and the detailed reasons given in the chapter on Legislative Relations, we do not suggest any changes in Articles 285 and 289 and Entry 32 of List I. We may, however, reiterate our recommendation made in para 2.35.13 of the chapter on Legislative Relations that a comprehensive law (under Clause (1) of Article 285 read with the saving clause in Entry 32 of List I) analogous to Section 135 of the Indian Railways Act, 1890 and Sections 3 and 4 of the Railways (Local Authorities' Taxation) Act, 1941 be passed making liable to taxation the properties of the departmental commercial undertakings of the Union Government at such fair and reasonable rates as may be notified from time to time by the Union Government after taking into consideration the recommendations of a person, who is or has been a Judge of a High Court or a District Judge.

10.5.35 So far as the issue of service charges is concerned, since April 1, 1954, on the recommendations of the Taxation Enquiry Commission, 1953, the Government of India has agreed to pay charges in lieu of property tax for the services rendered in respect of its properties by the local bodies. The services provided by the local bodies vary considerably and may include conservancy, water supply, drainage and sewerage, roads and lighting, etc. Large and compact Union Government's establishments, like the Railways and public sector undertakings, usually provide their own internal services and share the construction and maintenance costs on link services like roads, sewerage and drainage, with the local bodies.

10.5.36 The norms in regard to the service charges were determined by Government of India in 1962 and subsequently revised in 1967 and 1968.[22] The procedure has been systematised.

10.5.37 Problems like inadequate service charges paid for Government property or accumulation of their arrears are administrative issues and should be settled by mutual discussion between the Union and the State Governments. It is only fair that reasonable service charges should be paid by all beneficiaries.

10.5.38 We recommend that an official level committee may be set up to review the problems and evolve mutually agreeable solutions. This committee may have on its panel representatives of the Union Ministries of Finance, Home, Urban Development, Railways and from some State Governments.

10.5.39 Entry 40, List I:
'40. Lotteries organised by the Government of India or the Government of a State'.

A State Government has suggested that a new Entry may be added to the State List, reading 'Lotteries organised by the Government of a State' with suitable change in Entry 40 of List I. The import of the suggestion is that the State Governments be empowered in matters relating to lotteries organised by them and by implication, the jurisdiction of the Union should be restricted to lotteries organised by the Government of India. A similar suggestion has been made by another State Government and also by a State level political party.

10.5.40 We have dealt with this issue in detail in the chapter on Legislative Relations. State lotteries cannot remain confined within the boundaries of the State and the distributors are scattered all over the country. Problems of inter-State character have, indeed, arisen in this

22 Government of India, Ministry of Works, Housing and Supply O.M. No. 23(8)-v-Cont. dated 25-8-62; Ministry of Finance, Department of Coordination letter No. 4(7)-P/65 dated 29-3-67, and Ministry of Works, Housing and Supply, Directorate of Estates O.M. No. 20011(8)/67-Pol. dated 3-4-68 and 5-4-68.

regard.[23] It would not be possible for any particular State Government, being territorially limited in jurisdiction to legislate, if and when necessary, for regulating matters in regard to other States' lotteries. As observed in Chapter II, only Parliament can have the legislative competence to regulate such inter-State matters. We reiterate our finding that the changes proposed in respect of Entry 40, List I and addition of a corresponding Entry in the List II cannot be supported.

10.5.41 Entry 45, List I:
'45, Banking.'

A State Government has pointed out that in other federal countries like United States and Australia, the States have also established banks and, therefore, banking should not be an exclusively Union subject. It has suggested that in Entry 45, List I, 'Banking' should be replaced by 'Central Bank or Reserve Bank'. Further, the entry 'Banking' must be transferred to the Concurrent List. Another State Government has also suggested such a change arguing that banking represents too big a concentration of economic power and that there is no reason why it should be the monopoly of a particular level of Government.

10.5.42 We have dealt with the issue in the chapter on Legislative Relations also. As mentioned there, banking operations transcend beyond territorial limits of the States. Functionally, banking has close links with matters like 'Currency' coinage and legal tender; foreign exchange' (Entry 36), 'Foreign loans' (Entry 37), 'Bill of exchange, cheques, promissory notes and other like instruments' (Entry 46), 'Insurance' (Entry 47), and 'Stock exchanges and futures markets' (Entry 48) which all belong to the Union List. Banking is also basic to trade and, indeed, to all aspects of socio-economic development and planning. Centralised control is essential for proper credit management and implementation of monetary policy. Banks have a crucial role in the economy and there is need to regulate their activities so as to ensure that they are in consonance with the economic and development policies and are fully integrated with them. We are of the view that the subject 'Banking' should continue in the Union List and the transfer of Entry 45 'Banking' to the Concurrent List would not be desirable in our special situation.

10.5.43 Entry 84, List I: A State Government has suggested that the States should be allowed to levy excise duties on items like sugar, molasses, and *Khandsari*. This suggestion implies transfer of taxation powers from the Union to the States with respect to the items cited.

10.5.44 The items under reference are classified in Chapter 17 of the Central Excise Tariff Act. At present, no Central Excise Duty on *Khandsari* is being levied. Sale of sugar is one of the items covered by the Central Sales Tax Act, 1956 and the Additional Duties of Excise (Goods of Special Importance) Act, 1957. Sugar industry also finds a place in the First Schedule of the Industries (Development and Regulation) Act, 1951 since its inception. The importance of sugar and related items in the context of industry as well as an item of mass consumption is obvious. Sugar has foreign trade implications also. An integrated and uniform policy with respect to production, pricing, distribution, storage, trade, taxation, etc., in regard to items like sugar is called for and it has to be a part of national economic policy. Transferring power of excise taxation to States in respect of these items may create difficulties in the implementation of national policies. Moreover, the proceeds of Union Excise Duty (the basic duty) on sugar, are already being shared with the States (at present 45 per cent) on approval by Parliament.[24]

10.5.45 We are, therefore, not persuaded to recommend that the States be given the power to levy excise duty on sugar, molasses and *Khandsari*.

23 See, for example, *H. Anrai and others* v. *State of Maharashtra*, AIR 1984 SC 78.
24 Sugar is also subject to Additional Excise Duty in lieu of Sales Tax and the net proceeds of the duty, except the portion attributable to Union Territories, are distributed to the States.

10.5.46 A State Government has suggested that excise duty on industrial units, defined by Parliament by law as small-scale units, may be excluded from the jurisdiction of the Union and shifted to the States. It has been argued by this State that as the burden of excise duties ultimately falls on the consumers of excisable items in the form of higher prices, the higher per capital-(per capita) income States, because of their larger consumption of such items, contribute a relatively higher proportion of the excise revenue, but the distribution criteria adopted by the Finance Commission affect redistribution of such revenues in favour of the less-developed States. The State Government has pleaded that an alternate arrangement which would be fair to all the States and also provide them a strong incentive to develop industrial production should be evolved. According to it, if the excise duty on small scale unit is made leviable by the States and if the definition of small-scale industries is liberalised by Parliament, this could become a growing source of revenue to the States and provide them incentive to develop the small-scale sector.

10.5.47 Several products in the small-scale sector have wide inter-industrial and inter-State linkages and it will create problems if they are subjected to differential rates of excise. Moreover, the present efforts towards rationalisation of commodity taxation in the form of MODVAT will face serious administrative difficulties if levy of excise duties is bifurcated between the Union and the State Governments corresponding to scale of production. Administrative problems will also be encountered in plugging evasion of excise by the entrepreneurs who often exhibit some of the stages of production as taking place in the small-scale sector. At present, excise duties, including those on production in small industries, are sharable with the States as per provisions of Article 272. All the States benefit under this sharing arrangement. The Finance Commissions' formulae for allocation of the divisible portion of Union's tax-revenue among the States are based on a number of considerations, including the re-assessed revenue and expenditure forecasts of the States, the desired extent of re-distribution, amounts of grants-in-aid of revenues, etc. Such re-distribution of revenues effected on the recommendations of the Finance Commissions is an essential ingredient of inter-governmental sharing of resources. Mere consideration of the 'collection' factor in permitting the States to levy excise on small-scale industries individually, which is implied in the above-mentioned proposal of a State Government, would run counter to this spirit and place the less-developed States in particular, at a disadvantage. However, the manner of allocation of the divisible tax-revenues and the relative weights to be given to the various components of the formulae are matters to be considered by the Finance Commissions from time to time. It is best to leave these matters to their expert judgement. So far as the argument for giving the States incentive to promote small-scale industries is concerned, it may be pointed out that the Union Government also is providing significant support to this sector.

10.5.48 In view of the above considerations, it is not possible to support the suggestion that the power to levy excise duty on small-scale sector be shifted from the Union List to the State List.

10.5.49 Entry 85, List I: A State Government has suggested that the States may be authorised to levy their own Corporation Tax on companies whose factories are located in their areas. The suggestion has been made in the contest of augmenting the States' resources.

10.5.50 By virtue of Entry 85 of List I read with Article 270(4)(a), the receipts from Corporation Tax belong exclusively to the Union Government. Historically, the power to impose this tax in India has always been with the Union. The main reasons for reserving this power for the Union have been two-fold. Firstly, it ensures uniformity of approach to the taxation of corporate incomes and profits. Secondly, this arrangement secures greater efficiency in the administration of this tax. It obviates problems which arise in determining the locale of income accruals where units and offices of the same company or undertaking are located in different States and, incidentally makes evasion of tax more difficult.

10.5.51 This State Government has, however, not indicated how such an authorisation can be made. If this suggestion of the State Government implies conferring of concurrent jurisdiction on the Union and the States to levy this tax *or* delegation of the legislative power of imposing this tax by the Union to the States, it will run counter to the basic scheme of division of taxation powers between the Union and the States envisaged by the Constitution. The principles on which the taxation powers have been divided by the Constitution between the Union and the States, and none of them has been included in the sphere of their concurrent jurisdiction, have been explained in paragraph 10.2.15 *ante*. The alternative aspect as to delegation by the Union of its legislative power of taxation has also been considered in the chapter of Legislative Relations (paragraph 2.34.02). Suffice it to say here that neither aspect of this suggestion is based on *terra firma*.

10.5.52 For all the foregoing reasons, we do not agree with the suggestion that the States should also be authorised to levy this tax on companies located within their territories.

10.5.53 Entry 97, List I:
'97. Any other matter not enumerated in List II or List III including any tax not mentioned in either of these Lists'.

A suggestion has been made that the above Entry may be transferred to List II.

10.5.54 In the chapter on Legislative Relations, we have already dealt with this issue in some detail in the context of Article 248. Here we are basically concerned with the residuary power of taxation. On five occasions, so far, these provisions have been invoked for enacting taxation laws which include tax on gifts of movable and immovable property, including land;[25] wealth tax;[26] a tax on building contracts, and a cess upon the entry of sugarcane into premises of a factory.[27] In our Constitution, the heads of taxation have been enumerated specifically in the Union and the State Lists but no such head has been placed in the Concurrent List. We have already noted in Chapter II that the power to tax may be invoked not only to raise resources but also to regulate economic action. New subjects of taxation may involve matters with inter-State or national implications, requiring uniformity in approach. For these and other reasons indicated in Chapter II, we do not agree with the suggestion that residual taxation powers under Entry 97, List I be transferred either to the State List or the Concurrent List.

10.5.55 Entry 57, List II:
'57. Taxes on vehicles, whether mechanically propelled or not, suitable for use on roads, including tram cars subject to the provisions of Entry 35 of List III'.

A State Government has suggested that the expression 'subject to the provisions of Entry 35 of List III' in the above Entry may be deleted and a new Entry[28] in the List II may be added, as under:
'Entry 57-A: Taxes on mechanically propelled vehicles including the principles on which taxes on such vehicles are to be levied'.

Another State Government has also made a similar proposal.

10.5.56 The above proposal amounts to fully empowering the States not only to levy a tax on such vehicles but also lay down the principles on which such taxes are to be levied. Under the present arrangements, the restriction on States' power in respect of Entry 57 (List II) arises only in case of repugnancy from any Union legislation under Entry 35 (List III). According to our information, no law has yet been enacted by Parliament under Entry 35 of List III. The issue raised is, therefore, at present premature and mainly academic.

25 *Second Gift Tax Officer* v. *Hazareth, AIR.* 1970 SC 999.
26 *Union of India,* v. *Dhillon, AIR.* 1972 SC 1061.
27 *Mithan Lal* v. *State of Delhi,* 1959 SCR 445.
28 This subject at present is covered by Entry 35 of List III which reads: '35. Mechanically propelled vehicles including the principles on which taxes on such vehicles are to be levied'.

10.5.57 We have been informed by the Union Ministry of Finance that there had been a wide disparity of motor vehicle taxes in different States and the vehicle operators have been representing against the resultant problems, specially in inter-State vehicular movements. Distortions have also been observed in the rates and policy on vehicle-registration followed by different States. One of the measures evolved is the scheme of national permits and composite fee.

10.5.58 Development of the transport sector is vital for the growth of the economy and development of inter-State trade and social intercourse. It is desirable to evolve uniform principles of taxation in this sector, so that free transport of goods through various States is not impeded. This is possible only if the Union has necessary powers to ensure uniformity in the main principles of the laws of the States with respect to tax on such vehicles, throughout the country. This is the rationale for including Entry 35 in the Concurrent List. We are, therefore, unable to support the suggestion for change in the constitutional arrangements in this regard.

10.5.59 Entry 60, List II:
'60. Taxes on professions, trades, callings and employments'.

The scope of these taxes has been spelt out in Article 276. According to clause (2) of that Article, the total amount payable by a persons on account of these taxes 'shall not exceed two hundred and fifty rupees per annum'. Because of this limit, it has been alleged, the yields from such taxes, wherever levied, have been a minor source of revenue to the concerned States. It has been suggested by several States that this limit should be suitably raised in view of several-fold increase in income levels. If this is to be done, amendment of clause (2) of Article 276 will be necessary.

10.5.60 We are of the view that there is a strong case for upward revision of the monetary limit fixed 37 years ago on taxes leviable under Entry 60, List II and for periodic review of this limit in view of persistent inflation. The linkage between its incidence and that of Income Tax will also have to be considered simultaneously. We have been given to understand by the Union Ministry of Finance that it is already considering the revision of the monetary limit on professions tax, etc. In view of the same, we do not wish to make any specific recommendation in regard to a higher limit to be fixed in Article 276, except that such limit should be revised at frequent intervals in consultation with the States.

TAXATION BY STATES UNDER ARTICLES 287 AND 288

10.5.61 A State Government has suggested that the States should be allowed to levy tax on power sold to the railways as the railways are a commercial organisation. Article 287 lays down, among other things, that save 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 consumption or sale of electricity consumed or sold to Government of India or consumed by the railways.

10.5.62 Indian railways constitute a basic-infra-structure. With the gradual shift from coal and diesel to electric traction, the consumption of power by railways is likely to increase. In the construction and maintenance of railway works, the consumption of electricity by railways may significantly add to its costs. In our opinion this may have serious repercussions on the extension and operation of railways. We, therefore, do not agree with the suggestion that the States should be given unrestricted power to levy a tax on electricity sold by the States to the railways by effecting an amendment to Article 287 of the Constitution.

10.5.63 Further, a suggestion has been made that Article 288(2) may be suitably amended to enable the State Legislature to impose a tax in respect of water or electricity stored, generated, consumed, distributed or sold by any authority whether subservient to the Union or a State Government. The proposal seems to imply removal of preconditions under Clause (1) of that Article requiring President's prior approval for effecting such a legislation by a State.

10.5.64 We have considered the above issue in the chapter on Legislative Relations. In the present context, we may reiterate that the provision under Clause (2) of the Article 288 is a corollary to the principle of 'inter-governmental tax immunities'. Further, inasmuch as subject of taxation under this clause functionally involves inter-State aspects, the same becomes a matter of national concern, given the crucial significance of the items of water and electricity for the economy. Hence, the justification of the provision for the President's prior approval to a Bill seeking to impose such taxation. We are, therefore, of the view that Article 288(2) needs no change.

10.5.65 An all-India political party has suggested that the States should be permitted to tax generation of electricity within their areas as distinguished from mere sale of electricity. The basic principle followed in the Constitution in the division of taxation powers between the Union and the States is that tax on production, with a few exceptions, is levied by the Union and on sale by the State Governments. In our opinion, this principle is germane to taxation of electricity also. Electricity is an important ingredient of infrastructure. While its generation has to be location-specific in most cases, its consumption may be of inter-State significance. Even on taxation of inter-State sale of electricity, limitations have been put on States' powers, *vide* Article 288. A tax on generation of electricity by the States, if allowed, might operate as an additional barrier to inter-State flow of this strategic input. In view of these considerations, we do not agree with the suggestion that the States may be allowed to levy tax on generation of electricity.

TAXATION OF AGRICULTURAL INCOME

10.5.66 We have noted in paragraphs 10.3.06 and 10.3.07 that a criticism levelled against the States is that they have not sufficiently made use of the taxation powers allotted to them. In particular, the example of not levying or withdrawing the levy of Agricultural Income Tax is often cited. An all-India political party has submitted to us as follows:

> Under Entry 46 of the State List, the State can levy tax on agricultural income. Because of the efforts as to the enormous expansion of irrigation facility, hybrid seeds, chemical fertilisers and research in soil fertility, a very large number of agriculturalists have come to occupy the upper bracket of elite group in the society. Green Revolution to the extent of burgeoning stocks of Food Corporation of India, search of export market of wheat and rice and ever-rising support prices for agricultural products have combined to bring into existence an affluent class of agriculturists, yet, save Kerala no State has levied agricultural income tax ...... It is a truism that State Governments in order to keep intact their vote banks do not levy taxes and shed crocodile tears of shortage of resources.

A suggestion often made is that in order to overcome the resistance by interested groups and in the interest of uniformity in taxation, the Union may levy a tax on agricultural income and its net proceeds be assigned to the States.

10.5.67 The Government of India Act, 1935 empowered the Provinces to levy tax on agricultural incomes while the income tax on other incomes was allotted to the Federal Government. This division was retained in the Constitution. At present, about half a dozen States are levying Agricultural Income Tax. In three of them, it is confined to plantation crops. Several States, which had been earlier levying taxes on agricultural incomes, gave them up or are collecting only nominal amounts following various exemptions.

10.5.68 In order to ascertain the factual position and views of the State Governments on the type of criticisms mentioned in para 10.5.66 above, we had issued a Supplementary Questionnaire. Several States have highlighted serious problems in the assessment of agricultural incomes; shrinkage of the tax bases due to land reforms (ceiling on holding); widely dispersed potential assessees; fluctuations in production and incomes due to vagaries of nature; problems in maintaining systematic accounts of income and expenditure in agriculture, etc. A few State Governments are of the view that a direct tax on agricultural incomes will act as a disincentive to the spread of improved technology and high productivity.

10.5.69 The State Governments have generally expressed reservations and have opposed the suggestion that the Union Government may levy a tax on agricultural incomes and assign the net proceeds to the States. They have given different reasons for the same. Those already levying the tax on agricultural incomes are of the view that there will be no additional advantage if the tax is levied by the Union Government. Others have highlighted the difficulties in levying Agricultural Income Tax and pointed out that the Union Government will face similar problems. Indeed, according to them there is not much scope for such a tax. Some of them have also expressed apprehensions about the alternative of the Union levying the tax and have cited the 'unhappy' experience of the scheme of Additional Excise Duties in lieu of Sales Tax. Yet another State Government has argued that it was not so much a question of raising revenues as of a State's discretion to levy or not to levy a tax. Another State Government has pointed out that fixation of agricultural prices at levels much lower than those recommended by the States is already a tax in disguise on the agricultural sector. Only one State Government has suggested that in the interests of raising revenue and a uniform tax on agricultural sector, the Union Government might levy this tax as per arrangements under Article 268.

10.5.70 The Union Ministry of Finance has observed:

> ....the Central Government has no intention of seeking a transfer of power to tax agricultural incomes on behalf of the States for the following reasons:
>
> While there may be justification for imposition of agricultural income tax in view of increased income due to the Green Revolution, substantial investment in the agricultural sector, low revenues raised from the agricultural sector, and greater need for raising additional resources for development, there would, however, be serious difficulties in the implementation of this policy at the Central level due to conceptual difficulties regarding the definition of agricultural income. No uniform definition of agricultural income can be precisely formulated due to diversity of the quality and productivity of land. Moreover, due to the illiteracy of the agricultural population, agriculturists would not be able to maintain accounts for taxation purposes and may not be able to follow the rules and regulations prescribed. Besides, some sort of agricultural income tax is already being levied by a few States and others could follow suit.

10.5.71 In the Long Term Fiscal Policy announced by the Government of India in December 1985 also it was recognised that taxation of agricultural income presented many conceptual and administrative problems. It categorically stated:

> Land revenue and taxation of agricultural income are States' subjects under the Constitution. The Centre has no intention of seeking any change in this position.[29]

10.5.72 Taxation of agricultural income is, indeed, a sensitive matter requiring simultaneous consideration of an appropriate base, administrative convenience and costs, reasonable yield from the tax, parity with tax burden on non-agricultural sector, peculiar nature of agriculture as an enterprise, impact of the tax on productivity improvements in agriculture, and the like. Both the Union and the State Governments do not also at present seem to be inclined for a change in the constitutional provision in regard to Entry 46 of List II. We have also taken note of the findings of a number of expert studies[30] in this

29 Government of India, Ministry of Finance - *Long Term Fiscal Policy*, 1985, para 5.36, p. 35.

30 See, for example, the Reports of *Direct Taxes Enquiry Committee*, 1971 (Chairman: Justice K.N. Wanchoo), *Committee on Taxation on Agricultural Wealth and Income*, 1972 (Chairman: Dr. K.N. Raj), and *Direct Tax Laws Committee*, 1978 (Chairman: G.C. Chokshi).

regard. In view of the problems highlighted by the Union and the State Governments as well as the expert studies, the question of raising resources from this and other related aspects would require an in-depth and comprehensive consideration in the National Economic and Development Council.

RATIONALE OF CONSTITUTIONAL SCHEME

10.5.73 The present division of fields of taxation between the Union and the States is based on economic and administrative rationale. Levying of taxes, with inter-State base and where uniformity in rates is desirable, are(is) with the Union Government. Taxes that are location-specific are with the States. Canons of efficiency and equity in administration of taxes and the imperative need for the Union to have adequate resources, *inter alia,* to help the States with lower level of socio-economic development and tax-potential, leave hardly any scope for shifting any major sources of revenue of(to) the States from the present allocation of areas of taxation to the Union. We may note here the views of the Administrative Reforms Commission Study Team that, if at all, a review of taxation powers is carried out, economic considerations would most probably compel a shift in favour of the Union and not the other way. Some experts have also expressed similar views during their evidence before us.

10.5.74 A well balanced distribution of heads of taxation based on economic and administrative rationale between the Union and the States and adequate arrangements for sharing of resources is vital for the proper functioning of the two-tier polity. We are of the firm view that the basic scheme of the Constitution dividing the field of taxation between the Union and the States and incorporating adequate arrangements for sharing of resources between them, is sound and no major modifications in it are called for.

10.5.75 We have, in the chapter on Legislative Relations (paragraph 2.4.04), referred to the memorandum submitted by a Regional Party in which it has referred to the draft resolution of its Working Committee demanding that the interference of the Union should be restricted to Defence, Foreign Relations, Currency and General Communications only and all other governmental powers (including residuary powers) should be assigned to the States. Further, the States would contribute for the expenditure of the Union in respect of the above mentioned subjects. We have pointed out therein that the resolution of the 'Whole House' of the same party had substantially amended that in the final resolution. The State Government supported by this Regional Party has not made such an extreme demand and while suggesting various changes in the Seventh Schedule to the Constitution, it has not asked for any major change with respect to the heads of taxation enumerated in the Union List.

10.5.76 As explained in paragraph 2.9.12 to 2.9.15 of the chapter on Legislative Relations, no Union or federation can survive if it has no financial resources of its own and is entirely dependent on contributions from the constituent units. Indeed, this proposal cuts at the very root of the basic postulate that both the Union and State Governments should each have independent financial resources of its own to meet bulk of the expenses for its exclusive functions.

10.5.77 It is pertinent to note here that approximately 85 per cent of the Union's tax revenues are collected from offices located in eight port and metropolitan cities situated in seven maritime States and one Union Territory.

10.5.78 Owing to different levels of development obtaining in the country, the tax potentials of States vary widely. If the financial arrangement as suggested by the regional party is adopted, a few States would be able to collect for themselves most of the revenues and all the less-developed States would be in perpetual financial crisis. All the advantages of efficiency in tax collection, uniformity in rates, economy in tax administration, etc., will be lost. Trade barriers will come up and the Union will collapse.

10.5.79 In view of the above considerations, we are unable to support the scheme of financial arrangements implicit in the suggestion referred to in para 10.5.75 above.

6. ENLARGEMENT OF THE DIVISIBLE POOL

10.6.01 We now consider the suggestions made by many State Governments and experts for the enlargement of the States' resources within the existing constitutional scheme of division of taxation powers. All the State Governments and many experts have emphasised the need for extending the present divisible pool which at present mainly consists of the mandatorily sharable Income Tax and permissively sharable Union Excise Duties. We have already noted in Section 4 the substantial increase in resources transferred to the States over the period 1951-85. Considering the transfers through the mechanism of the Finance Commission, it is seen that overall devolution effected has gone up from Rs 476 crore (Annexures X.5 and X.6) (Not inserted) during the period of the First Finance Commission (1952-57) to an estimated Rs 39,452 crore during the Eighth Finance Commission period (1984-89). Since the First Finance Commission, the devolution of revenues on account of Union taxes which are sharable, has increased significantly in relation to the total revenue realised from these taxes as well as to the total tax receipts and total revenue resources of the Union. This is evident from the following table:

Sr. No. (1)	(2)	1952-57 (3)	1979-84 (4)	1984-89 (estimated) (5)
1.	Income Tax transferred as percentage of total Income Tax receipts of the Union	42.3	68.3	*
2.	Union Excise Duties transferred as a percentage of total receipts from Union Excise Duties	13.1	42.1	*
3.	Combined Income Tax and Union Excise Duties transferred as a percentage of the total receipts from these taxes	28.3	46.6	47.6
4.	Tax devolution as percentage of total tax receipts	15.7	26.8	27.6
5.	Total devolution (taxes+grants as percentage of total receipts on revenue account	17.1	23.6	24.1

* Not available separately.
Sources: (1) Ministry of Finance - *Indian Economic Statistics, Vol. II - Public Finance,* various issues.
(2) *Report of the Eighth Finance Commission, 1984.*

10.6.02 The various suggestions requiring changes in the arrangements regarding the divisible pool, i.e., proceeds of the taxes levied by the Union but sharable with the States, may be grouped into three categories:

(i) All tax receipts of the Union be made sharable with the States.

(ii) Fix the collective share of all the States in the Constitution and leave its allocation among the States *inter se* to be done on the recommendations of the Finance Commission.

(iii) Enlargement of the present sharable pool by including the proceeds from any or all of the following:

(a) Corporation Tax,

(b) Surcharge on Income Tax,

(c) Some other Union Taxes, e.g., Customs Duty, and

(d) Revenue from increase in administered prices of items like petroleum and steel, yields from schemes like Special Bearer Bonds, and Compulsory Deposits (Income Tax Payers) Scheme, 1974.

TOTAL REVENUES OF UNION AS DIVISIBLE POOL

10.6.03 A few States, some political parties and other knowledgeable persons have urged that the States may be given a share out of the total tax revenues of the Union on the ground that so long as the total quantum of transfers remains the same, it is immaterial whether the share comes out of specified taxes or out of the total tax receipts. It is argued that in this scheme the base will be larger and the States will be insulated to a greater extent from the effects of fluctuations of individual sharable taxes and would thus be given a more predictable and assured share. The proponents of this view point out that as the share of the States in Income Tax has already reached a high level (85 per cent), the Union Government may lose interest in maximising revenues from this source. They also allege that in order to reserve some resources for its exclusive use, the Union Government has been resorting to increasing administered prices on certain items rather than the sharable Union Excise Duties. So, in order to get over the disincentive in raising revenue from the two taxes (with very high percentage of shares for States) and absolving the Union Government of the criticism of manipulating resources out of the divisible pool, it would be advantageous to make the entire receipts of the Union divisible.

10.6.04 We have considered these suggestions carefully. At the time of the framing of the Constitution also, this matter came up for consideration. The Sarkar (Expert) Committee made a specific recommendation that certain taxes like duties of customs (including those on exports) should be for the exclusive use of the Union. Such duties are subject to frequent adjustments keeping in view the terms of external trade and, therefore, are not suitable for sharing. Further, the scheme of the Constitution earmarking certain taxes for the exclusive use of the Union is sound in view of the very onerous responsibilities cast on it. We are of the view that while there is no particular advantage in bringing all tax receipts into the divisible pool, it may, on the other hand, place the Union at a disadvantage.

FIXED SHARES IN CONSTITUTION

10.6.05 Yet another aspect of division of resources for consideration is the suggestion that the percentage shares of States should be built into the Constitution and the Finance Commission then need concern itself only with the division of such resources among the States. A State Government and a political party have suggested that at least 75 per cent of the revenue of the Union should be made sharable with the States as a constitutional obligation. They have, however, not spelt out the basis for the same.

10.5.06 We have already noted that at the time of the framing of the Constitution, Income Tax was the most important source of revenue. Revenue from Union Excise Duties was small and from Corporation Tax insignificant. Today, Union Excise Duties and Corporation Tax have, by far, overtaken the Income Tax. A moment's reflection would show that the States will be put to great disadvantage if percentage shares were fixed in the Constitution itself. The situation is dynamic, both in regard to availability of resources and in regard to needs of the Union and the States. It is the hallmark of the mechanism of the Finance Commission provided in our Constitution that it takes into account such factors in recommending a reasonable sharing of resources. We are not in favour of changing this system in view of its obvious merits. Further, a transfer of as high as 75 per cent of Union's revenue resources to the States is most impracticable inasmuch as such priority items as defence, interest payments and subsidies at present absorb about two-thirds of the Union's revenue resources.

SELECTIVE ENLARGEMENT OF DIVISIBLE POOL

Corporation Tax

10.6.07 We now consider the suggestion that the divisible pool may be enlarged by adding to it proceeds of some specified taxes, e.g., Corporation Tax, Surcharge on Income Tax, etc. A number of State Governments and others have suggested that the proceeds from the Corporation Tax should be included in the divisible pool. This demand stems from the fact that in 1959, Income Tax paid by companies, which was earlier included in Income Tax and was, therefore, mandatorily sharable with the States, was converted into Corporation Tax which, as per provision of Article 270, ceased to be sharable. In due course, it proved to be a buoyant source of revenue to the Union Government. Article 366(6) defines Corporation Tax as 'any tax on income so far as that tax is payable by companies' subject to the qualifications that it is not chargeable in respect of agricultural income, that no deductions in tax are made with respect to the authorised dividends and that the tax so paid is not taken into account in computing the income for purposes of Income Tax, etc., thereon.

10.6.08 A simplification in the scheme of company taxation was introduced in 1959. Prior to it, out of the Income Tax paid by a company before declaring the dividends, a portion of such tax was 'deemed' to have been paid by the shareholders. When the shareholders' income was subsequently assessed for purposes of Income Tax the dividends were included in it, after being 'grossed' (i.e., portion of 'deemed' tax paid added to it). The slab for their Income Tax and the amount was then determined and out of the Income Tax liability the amount of 'deemed' tax-paid deducted. As this process of grossing was found 'somewhat complicated',[31] the entire Income Tax Paid by companies was defined as Corporation Tax.

10.6.09 This change, however, created a problem in Union-State financial relations inasmuch as, according to the Constitution, the proceeds of the Corporation Tax are not sharable with the States. Before 1959, the Corporation Tax was small compared to Income Tax, but later the receipts from it had overtaken those from Income Tax (Annexure X.7) (Not inserted). As this change came about at a time when the report of the Second Finance Commission was under implementation and the Third Finance Commission was yet to be 'constituted', compensatory *ad-hoc* grants were given to the States to make good their loss in the share of Income Tax. Since the reclassification of Income Tax on companies as Corporation Tax, most of the States have been asking for restoration of *status quo ante*. In view of the explicit constitutional provision precluding the revenues from the Corporation Tax being sharable with the States, the first five Finance Commissions did not consider this demand. The Third Finance Commission, however, recommended increase in States' share in the Income Tax in view of the reduction of the divisible pool consequent to the reclassification of Income Tax on companies as Corporation Tax. The Sixth Finance Commission suggested that the matter should be reviewed by the National Development Council and, at the same time, highlighted that inclusion of Corporation Tax in the divisible pool would not *ipso facto* upset the balance of the Union-State resources as it would depend upon the percentage of resources that would be allocated to the States. The Seventh Finance Commission also suggested that the Union Government should hold consultations with the State Governments to settle the issue of Corporation Tax.

10.6.10 The Eighth Finance Commission took the view that the States should have access to such highly elastic source of revenue as the Corporation Tax. It, however, did not favour the suggestion for making a grant to them in lieu of a share in the Corporation Tax as it would amount to 'circumventing' the Constitution.

10.6.11 The Union Ministry of Finance, whose comments were sought on this issue, has opposed the inclusion of Corporation Tax in the divisible pool on several grounds, viz., it is not provided for in the Constitution; the disadvantage to the States due to definitional change in 1959 has been compensated by the Finance Commissions by raising their share of Income Tax; the devolution to the States should be considered as a 'package'; a number of States are already having surpluses on revenue account consequent to devolutions from other sources whereas the Union Government is experiencing revenue deficits since 1979 and that the very fact of a tax being elastic should not be treated as a justification for its sharing. It has also been argued that the Finance Commission has several other ways of effecting transfer of revenues to the States.

31 See, Budget (1959-60) Speech of the then Union Finance Minister (Paragraphs 67 to 71). It was explained that the complications arose as (a) the rate of grossing depended on the rate at which company's profits were initially taxed, (b) there were problems and litigation when dividends were paid out of accumulated reserves, and (c) assessment of shareholders was delayed.

10.6.12 We have given careful consideration to the views of the Union Government as well as those of the States and the observations of the various Finance Commissions. We have already noted that at present 85 per cent of the net proceeds of Income Tax are distributed among the States. As a result, there may be a risk of the Union Government losing in future its interest in increasing the receipts from this tax. There is also very little scope for any further increase in the States' share of Income Tax.

10.6.13 Further, as a consequence of the Eighth Finance Commission's recommendations, as much as 45 per cent of the net proceeds of Union Excise Duties constitute the share of the States. Here again, a significant increase in this share, if resorted to in future, might act as a disincentive to the Union to increase the receipts from the Union Excise Duties and look more towards non-sharable revenues.

10.6.14 We have presented in the Table below the Additional Resource Mobilisation (ARM) efforts of the Union Government conveniently divided into three periods:

(Rs crore)

Period	Income Tax	Union Excise Duties	Customs Duties	Corporation Tax	Others	Total
(1)	(2)	(3)	(4)	(5)	(6)	(7)
1974-75 to	9.90	1,004.04	99.09	95.50	-95.18	1,113.05
1978-79	(0.9)	(90.2)	(8.9)	(8.6)	-(8.6)	(100.0)
1979-80 to	-111.30	1,153.14	1,242.68	108.50	3.55	2,396.57
1983-84	-(4.6)	(48.1)	(51.9)	(4.5)	(0.1)	(100.0)
1984-85 to	-244.00	130.21	1,152.27	244.00	-169.76	1,112.72
1986-87	-(21.9)	(11.7)	(103.6)	(21.9)	-(15.3)	(100.0)

Note: Figures in parentheses are percentages to total additional resource mobilisation. The data is as shown in the relevant year's budget documents presented to Parliament. The negative sign indicates taxes given up or concessions given.

The above figures do not include additional resources raised by the Union through revision in administered prices, railway fares and freight and in items of posts and telecommunications, which are not shared with the States. The Table above shows that while there has been a negative ARM in the case of Income Tax, Corporation Tax has been found to be a good source for additional resource mobilisation. Union Excise Duties contributed 90.2 per cent of the ARM in the seventies with Customs giving only 8.9 per cent. In the latest period it is the reverse with Customs Duties contributing 103.6 per cent and Union Excise Duties only 11.7 per cent. There may be many reasons for these changes in the pattern of ARM but the trend is significant.

10.6.15 It is a fundamental principle of taxation that the taxing authority should have interest in its proceeds. In order to maintain this principle and giving a more meaningful choice to the Union among fiscal alternatives, it is necessary to enlarge the base of devolution to the States but with a lower percentage share in individual taxes. This can be done by bringing into the divisible pool a major Union tax but still keeping a sizeable revenue source for exclusive utilisation by the Union. It is, therefore, necessary to enlarge the base of devolution. Corporation Tax is the largest source of tax revenue after the Union Excise Duties and Customs Duties.

10.6.16 We recommend that by an appropriate amendment of the Constitution, the net proceeds of Corporation Tax may be made permissibly sharable with the States, if and as Parliament may by law so provide. This would have the advantage of enlarging the base of devolution so that in the revenues of the States there would be greater stability and predictability in future. Further, being an elastic resource, the States would also benefit from its growth.

10.6.17 The justification for enlarging the divisible pool also emanates from the fact that in an inflationary situation the gap between the expenditure and revenues widens, particularly in case of poorer States. Inclusion of Corporation

Tax in the divisible pool would enable the States to cover partly this gap, since this tax responds well in an inflationary situation.

10.6.18 However, it is necessary to recognise that consequent upon inclusion of Corporation Tax in the divisible pool, adjustments will have to be carried out by suitably bringing down the shares of States in Income Tax and Union Excise Duties. If this recommendation is implemented in the middle of a period dealt with by a Finance Commission it may create serious complications. It would be for the Finance Commissions constituted in future to determine the quantum of transfers as well as the allocation among the States.

10.6.19 Keeping in view the constraints on the Union's finances, we suggest that the net proceeds of Corporation Tax, while continuing to form part of the Consolidated Fund of India, should be permissively sharable with the States and distributed among them on the authority of law passed by Parliament. This arrangement would impart the needed flexibility in revenue-sharing between the Union and the States.

10.6.20 A State Government has suggested that while the proceeds of Customs Duty may remain exclusively available to the Union, which at present fully cover the defence expenditure - its 'foremost constitutional responsibility' - 50 per cent of the revenue from Income Tax, Corporation Tax and the Union Excise Duties may go to the States as their share in Central taxes. This proposition has been made along with the proposals by this State Government that the Union should give up excise revenue on selected commodities to enable the States to raise an equivalent amount through additional Sales Tax on them and that the power to levy excise duty on small-scale industries should be transferred to the States. We have dealt with these proposals in paragraphs 10.5.03-10.5.04 and 10.5.46-10.5.48, respectively. Further, this State Government has suggested that the divisible portion of the Central taxes be allocated among the States on the basis of specific objective criteria with given rates.

10.6.21 States' share in the divisible pool and the principles of its inter-State allocation are to be determined on the recommendations of the Finance Commission which pays attention to the changing situations and needs of the Union and the individual States. As has already been discussed in paragraph 10.6.06, the present system has considerable merit and it would not be advantageous to proceed on the basis of fixed shares. Further, if a certain set of objective criteria were to be laid down before-hand, it will take away the needed flexibility in the revenue-sharing arrangement. The argument linking specific needs (viz., defence expenditure in this case) to the proceeds of a particular tax is not in accordance with the established principles of public finance. In view of the above reasons, it is not possible to agree with the scheme proposed by the State Government in the previous paragraph.

SURCHARGE ON INCOME TAX

10.6.22 The Constitution provides for the levy of a Surcharge on Income Tax, the proceeds of which are not sharable with the States. The Expert Committee on the Financial Provisions of the Union Constitution (1947) had treated Surcharge for the exclusive use of the Union Government but had simultaneously warned that it should be levied 'whenever conditions require such a levy; obviously such occasions should be rare and not last for long periods'. Surcharge was levied in 1951-52 and continued up to 1985. It has been used in many forms (e.g., surcharge, special surcharge, additional surcharge, etc.) and has in the past been distinguished between earned and unearned incomes (1957-58 to 1963-64) and salaried income (in 1960s). Since 1975, it was being levied in a uniform manner till March, 1985.

10.6.23 It may be seen from Annexure X.7 (Not inserted) that not only the revenue from Surcharge on Income Tax has increased sharply, its relative importance, gauged as percentage to Income Tax and Union's tax revenue, has also increased considerably and it has been continued for 34 years without interruption. This has given rise to the criticism that instead of meeting any special expenditure requirement, the Surcharge was being used by the Union Government as a regular source of revenue.

10.6.24 The States have also been raising the issue of bringing the Surcharge on Income Tax in the divisible pool before successive Finance Commissions. The first six Finance Commissions did not consider this demand in view of the explicit constitutional provisions. The Seventh Finance Commission, however, observed significantly that 'surcharge, continued indefinitely, could well be called an additional Income Tax, sharable with the rest of the proceeds of the Income Tax'.[32] The Eighth Finance Commission not only endorsed the views of the Seventh Commission but went further when it observed '.....for the sake of amicable Centre-State relations it (Union Government) should reconsider the indefinite continuance of the surcharge..... Therefore, we suggest that with the commencement of the financial year 1985-86, the Surcharge be withdrawn and the basic rates of Income Tax suitably adjusted'.[33]

10.6.25 We cannot but describe the continuous levying of Surcharge on Income Tax, in one form or the other, for thirty-four years ending March, 1985,* as substituting a special privilege for performing routine tasks. We have considered the various alternatives suggested like merging Surcharge with the basic rates thus making it sharable with the States, putting a ceiling on the period beyond which it should not be allowed in normal times, etc.

10.6.26 We are firmly of the view that the Surcharge on Income Tax should not be levied by the Union Government except for a specified purpose and for a strictly limited period only.

ADMINISTERED PRICES

10.6.27 Revisions in the prices of items like petroleum, steel, cement, etc., which are produced mostly in the Public Sector by the Union Government, have implications for Union-State financial relations. It is argued by the States that an increase in prices of these commodities results in placing substantial additional resources at the disposal of the Union Government. On the other hand, inasmuch as most of these items are essential for building up the basic infrastructure by the States, the costs of their projects go up for which they are not only not compensated, but available resources get spread thinly, thereby leading to a vicious circle of delay in completion causing further cost-escalations. It has been suggested by the States that instead of raising the administered prices, the Union Government should raise the Union Excise Duties which are sharable or otherwise agree to share the increased net receipts on account of increase in prices. Some of the States have suggested that such sharing should be applicable only in cases where the Central Public Sector enterprises are making profits.

10.6.28 There seems to be an insufficient appreciation of the role of prices of Public Sector products in such proposals. The Union Government has invested very large amounts in building up various Public Sector units mostly in such core sectors as steel, heavy engineering, etc. These units have not been generating the surpluses as expected of them for new investment. Moreover, in the Seventh Five-Year Plan, one of the important functions of the Public Sector enterprises is to generate surpluses for financing of further economic development. Another important function of pricing is to give appropriate signals to the products to utilise resources efficiently and to penalise inefficiency. Increase in prices could be due to a variety to factors and it would be nearly impossible to determine whether a part of it could be regarded as a substitute for increase in Excise Duty. Therefore, increases in administered prices do not easily lend themselves to sharing. The difficulty gets enhanced when other objectives of Public Sector, e.g., regional development, import-substitution, conserving a scarce product, etc., are simultaneously considered.

10.6.29 We are, therefore, of the view that it would not be advisable to make the proceeds of increase in administered prices sharable with the States.

32 *Report of the Finance Commission*, 1978, para 22, p. 82.
33 *Report of the Eighth Finance Commission*, 1984, para 5.10, p. 41.
* Re-imposed for the accounting year 1987-88 on selected incomes as part of package measures to meet drought expenditure.

SPECIAL BEARER BONDS AND COMPULSORY DEPOSITS SCHEME

10.6.30 With a view to improving the Government's financial position and reducing the budgetary deficit and also bringing out black money, the Government of India introduced the Special Bearer Bonds Scheme, 1981, effective from 2nd February, 1981. The Scheme provided certain immunities to the holders of these Bonds in order to encourage sale of these Bonds. According to the Ministry of Finance, an amount of Rs 964.59 crore (Rs 88.67 crore in 1980-81 and Rs 875.92 crore in 1981-82) was collected.

10.6.31 The Union Government introduced the Compulsory Deposit Scheme in July 1974, as a part of its measures to contain inflation. The scheme had two parts. The first part provided for compulsory deposit of whole of the additional dearness allowance given to Government servants. This was expected to immobilise about Rs 600 crore in a year. The second part of the scheme covered all Income Tax payers whose aggregate net annual income exceeded Rs 15,000. There were different slabs of deposit rates for different income groups. It was expected to bring in a sum of Rs 50 to Rs 55 crore in a year. Both categories of deposits were to be repaid in five annual instalments together with interest.

10.6.32 The States have criticised the two schemes as measures to circumvent increases in Income Tax or as directly resulting from the inability of the Union Government to administer the same efficiently. They have, therefore, argued that the receipts of these two measures should also be shared with them as they have the same tax-base as the mandatorily sharable Income Tax. It has also been argued that as they represent savings they could be shared like the Small Savings collections. On the other hand, it has been countered that Union Government's access to these resources is in the nature of loans which are not sharable with the States.

10.6.33 Demand for sharing of the proceeds from schemes like the Special Bearer Bonds and Compulsory Deposit (Income Tax Payers) Scheme, 1974, are only of academic and illustrative significance today as these are not in force now. We are of the view that the Union Government should adopt such measures only under special circumstances when considered necessary as part of its fiscal and monetary policies. Sharing of such capital receipts with States will be beset with a host of problems in regard to allocation, terms of repayment, etc. However, nothing prevents the Union Government from providing special purpose assistance to the States keeping in view its overall financial position and the receipts from these sources, if found necessary.

FISCAL POTENTIAL AND RESOURCE MOBILISATION

10.6.34 The above consideration of issues and suggestions in revenue-sharing between the Union and the States has been in the context of the realised revenue mobilisation. The pressures felt on resources is a typical feature of a developing economy. The problems in their sharing by the different levels of Government are bound to be less acute if the overall availability of resources is considerably larger. Economy in expenditure and prudence in fiscal management, i.e., greater efficiency in tax-assessment, tax-collection, better returns on investments on public enterprises, irrigation and power projects - at all levels of Government, are equally important factors which augment the totality of resources at the disposal of the nation as a whole. Further, the organic linkage in policies and measures adopted by different levels of Government in resource mobilisation and expenditure must be duly recognised. This, indeed, is the crux of the problem in Union-State financial relations.

In this regard, a State Government has urged: 'A proper development perspective for the country calls for greater and not less tax efforts by both the Centre and the States, as well as greater efficiency in public expenditure'. We fully agree with this perception.

10.6.35 A thorough examination of the potential and directions of revenue-raising both by the Union and the States is desirable. In our tax structure, the receipts from indirect taxes now contribute well over three-fourths of the total tax proceeds. In the resource mobilisation effort in future also, substantial reliance will have to be placed on indirect taxes. The Long Term Fiscal Policy announced by Government of India in December 1985 seeks to introduce reforms both in regard to direct and indirect taxes. It contains directions for rationalising and simplifying tax laws and securing uniformity in procedures for direct taxes. It also aims at simplification of Central Excise Duties, introduction of MODVAT, reduction in arrears, and periodic upgradation of specific duties. Although in the Constitution, the taxation powers of the Union and the States are not concurrent, functionally (e.g., in terms of impact on prices and elasticity of taxes), the Union taxes like Excise/MODVAT, Central Sales Tax, etc., interact with the States' Sales Tax. This has implications for actual use of taxation power by the States. The States complain that the Union Government's policies have restricted their scope to raise revenues from Sales Tax. There have been consultations between the Union and the States to levy the Consignment Tax. A comprehensive and expert consideration of reforms in taxation will be necessary to place consideration of Union-State fiscal relations by the concerned institutions in a proper perspective.

10.6.36 We recommend that an Expert Committee, with suitable representation on its penal(panel) from the States, may be appointed by the Union Government to recommend desirable directions of reforms in taxation and, *inter alia,* consider the potential for resource mobilisation by the Union and the States. The report of this Committee should be placed before the Standing Finance Sub-Committee of the National Economic and Development Council, the establishment of which has been recommended in Section 9.

7. PATTERN OF DEVOLUTION

ISSUES

10.7.01 We have noted that the devolution of resources from the Union to the States has been very significant. These transfers are crucial in effecting a balance in the sharing of over-all resources between the Union and the States and their distribution among the States *inter se*. Following are the important issues that have been raised in respect of the pattern and efficacy of devolution of resources from the Union to the States:

(i) The devolutions effected on the recommendations of the Finance Commission - a body which has its origin in the Constitution - constitute only a part of the total transfers. Bulk of the transfers made for the Plan and other purposes under Article 282 and 293 are 'discretionary', and by implication allow free-play to the Union Government's choice in respect of their magnitude and allocation. It is alleged that the expectations of the Constitution-makers that the devolution of resources from the Union to the States through the mechanism devised by them, in an impartial and 'automatic' manner free from 'interference', has suffered change.

(ii) Some expert studies have highlighted the iniquitous nature of the Central transfers with respect to allocations among the States. A few less-developed States have suggested special dispensation to them in Central transfers. Apart from the above issues, another aspect is whether the Union Government is transferring sufficient resources to the States. Before considering the above-mentioned issues, we may briefly review the factual position on the pattern of devolution of resources from the Union to the States.

PATTERN OF TRANSFERS

10.7.02 Devolution of resources from the Union to States may be placed under three categories:

(i) transfers based on the recommendations of the Finance Commission;
(ii) transfers by way of assistance for execution of the Plan recommended by Planning Commission, including Centrally Sponsored Schemes; and
(iii) others consisting of small savings loans, assistance for natural calamities, etc., canalised through the Union Finance Ministry.

Annexure X.4 (Not inserted) summarises the pattern of over-all transfers of resources from the Union to the States.

STATUTORY TRANSFERS

10.7.03 Transfers effected on the recommendation of the Finance Commission (called by some as 'statutory transfers') are normally determined for a period of five years. Bulk of these transfers are unconditional and have a built-in buoyancy with respect to the growth of the concerned tax receipts. In the totality of resource-transfers, those on the recommendations of the Finance Commissions accounted for 40 per cent during the period 1951-85.

CENTRAL PLAN ASSISTANCE

10.7.04 A substantial part of the transfers in the second category are by way of assistance for the execution of the State plans. These accounted for 31 per cent of the total resource transfers from the Union to the States during the period 1951-85. If to these transfers are added those on account of Central and Centrally Sponsored plan-schemes, the totality of plan transfers during the period 1951-85 works out to about 41 per cent of the total transfers. The Central assistance for the plan is based on the recommendations of the Planning Commission. It includes both loans and grants. During the Sixth Plan period the grant component in the total plan transfers was about 56 per cent. A large part of the Central assistance for the State plans is allocated on the basis of the Modified Gadgil Formula[34] and other pre-determined considerations. We have discussed and commented on this aspect in detail in the chapter on Economic and Social Planning.

OTHER TRANSFERS

10.7.05 Besides the transfers effected on the recommendations of the Finance Commission and on plan account, the Union Government gives grants and loans for various other purposes, like relief for natural calamities, improvement of roads, upgrading the salaries of teachers, relief and rehabilitation of displaced persons, etc. These comprise the third category. During the period 1951-85 such transfers accounted for about 19 per cent of the total transfers.

TRANSFERS ON REVENUE ACCOUNT

10.7.06 The pattern of Central transfers on revenue account (Annexure X.8) (Not inserted) shows that the transfers on the recommendations of the Finance Commission, comprising tax-shares, grant-in-aid under Article 275(1) and grants in lieu of other taxes, in the various Plan periods have generally been well over 60 per cent of the total transfers on revenue account. The 'shares in taxes' and grants-in-aid under Article 275(1) have reinforced each other to maintain a fairly stable share of such transfers taken together. The share of 'other grants' under Article 282, which are given as part of the Plan assistance for the various schemes of the Union Ministries, natural calamities, etc., outside the purview of the Finance Commission, has been significant and, on the average, a little over 37 per cent.

34 The formula (popularly known as Gadgil Formula) for allocating Central assistance for State Plans was originally evolved in 1968 and modified in 1980. After keeping aside provisions for the special-category States and some other specific purposes, the amount of Central assistance allocated among the States in the original and modified formulae has been (dependent) on the following criteria:

Sr. No.	Criteria	Weights (per cent)	
		In the Original Formula	As Modified by NDC in 1980 (Modified Gadgil Formula)
(1)	(2)	(3)	(4)
1.	Population	60	60
2.	Per capita income below the national average	10	20
3.	Per capita tax-effort	10	10
4.	Outlay on continuing irrigation and power projects	10	..
5.	Special problems	10	10
	Total	100	100

TRANSFERS ON CAPITAL ACCOUNT

10.7.07 The position of the States is significantly different on capital account as their borrowings other than the Central loans - reckoned as their 'own' resources are also to be allowed by the Union Government in accordance with Article 293 of the Constitution. Transfers to the States for financing rapidly increasing Plan outlays have been largely in the form of Central loans (gross). The trends in the pattern of States' indebtedness as given in Annexure X.9 (Not inserted) signify more than 70 per cent share of the Central loans in States' indebtedness and also a declining share of their internal debt - from the market and financial institutions.

TRANSFERS AND FINANCING OF STATES' EXPENDITURE

10.7.08 Financing of revenue expenditure of the States by different sources individually (Annexure X-10) (Not inserted) and cumulatively (Annexure X-11) (Not inserted) throws further light on the respective roles of States' own resources, Central transfers, the pattern of Central transfers and trends in States' finances. The 'own' resources of the States on the average have had 62 per cent share in financing their revenue expenditure. However, the 'share in taxes', which is the category most preferred by the States in view of its statutory and condition-free status and buoyancy, has been significant (23 per cent during 1951-85) and rising over the period. The two together, constitute 85 per cent of the States' revenue expenditure during 1951-85. If to this are added, 'grants-in-aid of revenue under Article 275(1)' and 'grants in lieu of other taxes, etc., also given on the basis of the Finance Commissions' recommendations, the total accounts for the financing of about 89 per cent revenue expenditure of the States. The scheme of financing of States' revenue expenditure resulted in an over-all surplus of 4.4 per cent during 1951-85, and has been quite substantial since 1974-75. The State-wise position would, however, show significant variations.

'STATUTORY' VS. 'DISCRETIONARY' TRANSFERS

10.7.09 It is often alleged that inasmuch as only 40 per cent of the total transfers from the Union have been effected on the recommendations of the Finance Commission envisaged in the Constitution, the balance of transfers has been discretionary in character. It is contended that Article 282 was intended to be a sort of residuary Article to take care of unexpected kind of things, *inter alia*, for making marginal adjustments; but the Plan grants made by the Union in excise of its power under Article 282, by assuming a dominant role in devolving resources to the States, have distorted the constitutional scheme. We have noted that although the financial assistance given to the States on the recommendations of the Finance Commission has substantially increased since the period of the First Five Year Plan the bulk of the transfers (close to 60 per cent during the period 1951-85) have been in the form of Plan and 'other transfers'.

10.7.10 This criticism has two aspects - one technical and academic, the other oblique and imputative. As regards the first, these transfers under Article 282 are discretionary only in a technical sense, as opposed to mandatory. Whereas sharing with or assignment to the States by the Union of the net proceeds of certain taxes mentioned in Article 270 and 269 (on the advice of the Finance Commission) is mandatory, there is no such constitutional obligation on the Union for making grants to the States under Article 282. The oblique aspect of this criticism, however, raises the question whether in substance and practice, the transfers made for Plan purposes under Article 282 on revenue account to the States are discretionary in the sense that they allow free-play to the Union Government's choice in respect of their magnitude and relative allocation.

10.7.11 So far as the Plan transfers are concerned the size of Central assistance for the Plan is determined as part of the exercise for the financing of the Five Year Plan, which is approved by the National Development Council on which all the States are represented. Any increase in the actual devolutions to the States over the Five Year Plan estimate corresponds to the assessed needs for the Plan on annual basis. This is effected on the advice of the Planning Commission. Indeed, there has not been any criticism from the States on increasing the flow of Central Plan assistance to them as compared to the Five Year Plan estimate or on its inter-State allocation. So far as the allocation of Central assistance for the State Plans is concerned, as has been discussed in detail in the chapter on Economic and Social Planning, bulk of it is decided in terms of the Modified Gadgil Formula and other objective determinants and special investments (including Tribal and Hill Areas Sub-plans) which are also approved by the National Development Council and are subject to review by that body. These do not leave any significant discretion to the Planning Commission which is confined to only 10 per cent allocation of Central assistance under the Modified Gadgil Formula. In the case of the Centrally Sponsored Schemes also, the pattern of financing, viz., Central assistance *vis-a-vis* States' own contribution, for the various schemes is determined and known well in advance. The States have also not objected to the flow of Central assistance as such in this respect. The thrust of their complaint is on the system of matching contribution and their allegedly inadequate involvement in the formulation of these schemes. These aspects, though otherwise very important, should not confuse the issue in question. We have dealt with them in detail in the chapter on Economic and Social Planning.

10.7.12 So far as the category of 'other transfers' (for natural calamities, etc.) is concerned, the variety of purposes for which they are made by their very nature cannot be sufficiently anticipated by either the Finance Commission or the Planning Commission. Such transfers are purpose-specific and have to cater to the contingent problems which arise from time to time. These transfers being mostly on revenue account, do not carry much repayment liability on the part of the States. The States have not voiced any serious complaints against these transfers. The study Team of the Administrative Reforms Commission, which examined in detail the use of Article 282 for such grants, observed that 'a constitutional amendment defining or restricting the scope of the Article is, therefore, not necessary, specially because to meet unforeseen situations, the Centre should have a degree of flexibility in the use of the Article'.[35] We fully endorse this observation.

10.7.13 In view of the above, the Plan and other transfers, which are labelled 'discretionary', do not amount to subversion of the constitutional scheme. They cannot be considered either unreasonable or discretionary in a literal sense as their allocation follows predetermined criteria, or is tied to meet specific requirements of the States. The large magnitude of Plan transfers should not pose any controversy in this regard as the framers of the Constitution could not anticipate the extent of development resource-needs under the Plans of the States. The significant growth of Central assistance to States for planned development is, indeed, a natural response to such needs. The crux of the matter is that the States' participation in the planning process should be such that the Plan transfers are treated by them as part of a commonly agreed programme for the deployment of the nation's resources. We have discussed at length this aspect in the chapter on Economic and Social Planning. In addition, in Section 8 we have dealt in detail with the controversy whether the Finance Commission could also attend to the assessment of financial requirements for the Plan.

10.7.14 We are of the view that the controversy between statutory vs. discretionary transfers to the States is based more on theoretical than realistic considerations. It is not humanly possible to devise fool-proof formulae which would make the totality of Central transfers conform fully to the ideal of automatic and free-from-interference devolutions. Some amount of flexibility and room for subjective judgement will have to be left to the concerned institutions to deal with the specific situations as they arise. What is really important is that the institutions involved should function in a fair and non-partisan manner and take decisions with due discernment and expertise, which are implicitly acceptable to the States.

35 Government of India - Administrative Reforms Commission - *Report of the Study Team on Centre-State Relationships* (1967), Vol. 1, para 4.23, p. 28.

EQUITY IN TRANSFERS

10.7.15 An important direction of enquiry in the Union-State financial relations is whether the transfers from the Union to the States have satisfied the basic principle of equity. The Directive Principles of State Policy enshrined in the Constitution require that the 'State' should strive to minimise inequalities amongst groups of people residing in different areas. In our country, both inter-State and intra-State disparities are glaring and persistent in the backdrop of overall under-development. Lack of adequate financial resources has been recognised to be one of the basic constraints in the development of the backward areas. Provision for necessary administrative services, social and industrial infrastructural facilities is crucial for mitigating regional disparities.

10.7.16 A number of empirical studies have been made to ascertain how far the transfers effected have been progressive. In Annexure X.12 (Not inserted) we have summarised the data indicating per capita transfers through channels of the Finance Commission. Planning Commission and the Union Finance Ministry. It will be observed that for several States, which are economically backward, the per capita transfers are lower than the all-States' average. The findings of the various studies indicate broadly that the transfers on the recommendations of the Finance Commissions and the Planning Commission have not been significantly progressive in earlier years. However, during the last three Five-Year Plan periods there has been considerable improvement in this regard. Transfers falling in the category of 'other transfers', which are mostly purpose-specific, have been found to be generally regressive, tending to dilute the progressivity of overall transfers to the States. Similar has been the pattern of allocation of the institutional finance from the commercial banks, term-lending financial institutions, etc. On the whole, several of the less-developed States have been getting less that the average per capita devolution and share in institutional finance. This has contributed to the persistence of regional disparities in the country.

10.7.17 Finance Commissions carry out a re-assessment of forecasts of revenue receipts and expenditure (on non-plan account) of the States before determining the devolutions necessary. Their formulae of tax devolutions have generally resulted in leaving substantial surpluses with about half the number of States. In the case of States still remaining in deficit, grants-in-aid under Article 275(1) have been given to make good the assessed gaps and needs. Resources of different States differ considerably owing to widely varying levels of development. Five or six States which have a better resource-base have surpluses from their own resources. Any further devolution only adds to their surpluses. Some other States, though not as well-off in respect of their own resources, reach the stage of surpluses consequent upon devolution of resources by the Finance Commission.

10.7.18 The weightage given to population size, which is essentially a scale factor, as a major criterion in the formulae of devolutions, when combined with other criteria, has resulted in lower per capita transfers to the less-developed States. The last two Finance Commissions, however, sought to evolve formulae with greater progressivity, by further emphasising the poverty criteria.

10.7.19 However, during the five-year period, on account of inflation, States' expenditure has gone up. To some extent it is compensated by increase in revenues on account of buoyancy in tax receipts. The States with revenue surpluses are better equipped to meet the adverse impact of inflation. On the other hand, grants-in-aid being fixed for most part, the effect of inflation is felt much more by the States in receipt of a larger proportion of grants. These States are precisely those which are less developed and lack the essential infra-structure which alone can enable them to develop quickly. The Seventh Finance Commission had observed as under:

> .... a Finance commission's scheme of transfers which leaves a few States with substantial surpluses on revenue account which can be ploughed back into fresh investments, and

the rest of the States with a zero surplus could contribute to widening of the economic disparities.[36]

10.7.20 The application of the Modified Gadgil Formula (increasing the weightage of the 'States having per capita income below the national average' from 10 to 20 per cent in lieu of the 'expenditure on continuing irrigation and power project') and provision of special Central assistance for the Tribal and Hill Areas Sub-Plans, North Eastern Council and Special Component Plans, has(have) made the allocation of Central Plan assistance more progressive.

10.7.21 Many suggestions have been placed before us in regard to the basis for inter-State allocations. The less-developed States have argued strongly in favour of formulae which place more resources at their disposal. On the other hand, the States with revenue surpluses have pointed out that they have their own peculiar problems, e.g., management of large metropolitan cities which, while generating resources, also require very large investments for providing essential services.

BACKWARD AREAS

10.7.22 Provision for the special needs and basic requirements of the backward areas, particularly in the backward States, would necessitate increasing attention to them in the allocation of funds by way of special provisions on soft terms over and above the general formula devolutions. The Union Government has a crucial role in helping the backward areas to get over the initial handicap of poor basic infrastructure. This would involve investments which may not produce returns for long years and, for the gestation period, need subsidisation by the Union Government. It is, indeed, in the long-run interests of the backward regions, and the country also, that by creating stimuli for development, they are helped to generate their own resources, rather than remain dependent indefinitely on the largesse of the Union, or the State Government, as the case might be. At the same time the overall resources being scarce, their(there) is need for caution to ensure that the incentives given to the backward regions for accelerating their development do not, in the reverse, jeopardise for want of resources, the tempo and levels of development achieved in the relatively developed areas.

10.7.23 The financial problems of backward areas are, indeed, challenging and involve both availability of sufficient financial resources and their effective utilisation. It will be necessary to ensure that the less-developed or backward areas and States get adequate resources to meet their special requirements and bring their standards of administration at par with the advanced States. Both, the Finance Commission and the Planning Commission, will have to take coordinated and concerted action in devolving adequate resources to the less developed States and those having large backward areas. The Planning Commission will have to take a comprehensive view of the flow of Central investment and other institutional finance to the less-developed areas. Suitable institutional mechanisms need to be devised to ensure financial support and tying-up of the funds to the specific projects in such areas.

UNION'S FINANCES AND TRANSFERS

10.7.24 Another issue which is important in the context of Union-State financial relations is whether the Union Government has been making reasonable transfers to the States and, further, whether these could be significantly enhanced. It may be seen from Annexure X.13 (Not inserted) that, of late, the Union Government has been transferring about one-third of gross resources raised by it to the States - the revenue account transfers showing an upward trend. Transfers from the Union continue to play an important role in meeting the expenditure of the States.

10.7.25 It is significant that since 1979-80 the Union Government has been running a deficit on revenue account (Annexure X.14) (Not inserted). The Balance from Current Revenues became negative in 1985-86. During the Seventh Plan

36 *Report of the Finance Commission*, 1978, Chapter 9, Para 17, p. 81.

period, the Balance from Current Revenues has been estimated at (-) Rs 12,011 crore. Thus, over the last several years the Union Government has been finding it increasingly difficult to meet its obligations on revenue account from its current budgetary resources and has had to take resource to meeting them from borrowed funds.

10.7.26 As noted earlier in para 10.4.17, approximately three-fourths of the non-Plan expenditure of the Union now consists of defence, interest payments and subsidies. In recent years, massive anti-poverty programmes have been taken up and these have added substantially to the revenue expenditure. Of the total receipts (gross) in 1986-87, defence interest payments and subsidies absorb 36 per cent, transfers to States and Union Territories 29 per cent, leaving 22 per cent for Central Plan and 13 per cent for Union's non-Plan expenditure.

10.7.27 The broad analysis of the pattern of Union Government's expenditure on revenue account brings out that while on development side expenditure on high priority items has been provided, in the non-developmental component, because of compulsions of defence, interest payments, subsidies, etc., not much manoeuvrability exists. Further, in addition to transfers of resources in the form of tax-shares and statutory and Plan grants substantial expenditure on subsidies and Central Sector and Centrally sponsored Schemes goes to benefit the States. The Union Government is thus already transferring substantial resources to the States. Under the present circumstances, there is need to pay attention to structural changes in transfers for which there is apparently greater scope.

10.7.28 However, the resource needs of the States also are not to be understated. The over-all situation, therefore, calls for all-out efforts to raise resources, increased rationality in their allocation at the two levels of Government, a judicious priority-ordering and improved efficiency in resource-management.

PATTERN OF EXPENDITURE OF UNION AND STATES

10.7.29 The over-all expenditure of the Union and the States has grown rapidly, especially in the wake of the fast-rising Plan expenditure. The annual trend-rates of growth work out to be 14.30 per cent in case of the Union and 13.52 per cent in case of the States for the period 1951-85. The proportion of developmental expenditure on revenue has been rising in the case of the Union as well as the States (Annexure X.15) (Not inserted). On capital account, an overwhelming part of the expenditure is incurred for developmental purposes. Net disbursements of loans account for about half of the Union's capital expenditure and more than one-third of that of the States. Development loans constitute about three-fourths of the loans disbursed.

10.7.30 Several experts have pointed out that substantial expenditure is incurred by both the Union and the State Governments on schemes which have come to be known as populist measures. These are often uneconomic but are supposed to earn popularity for the sponsoring Government. It will be in the best interests of the concerned Governments to take explicitly into account the high opportunity cost of such schemes and to examine whether any important programmes of development are compromised due to such diversion of scarce resources.

10.7.31 The Union Government provides directly large subsidies for a number of items of which fertiliser subsidy, food subsidy and subsidy for promotion of exports, constitute the bulk. The State Governments also give subsidies on schemes of food and nutrition, interest payments and on certain schemes for the benefit of the weaker sections. Apart from subsidies which can be directly seen as such, subsidisation is also inherent in a variety of measures, e.g., exemption fully or partially from a tax or duty; allowance to channelise investments into particular sectors; refund of certain taxes to exporters, etc. Cross-subsidies are given by public corporations to particular groups of clients at the expense of others.

10.7.32 The total amount of (i) direct, (ii) indirect and (iii) cross-subsidies is thus very large. The share of direct subsidies has been substantial since 1977-78. Unfortunately, no reliable estimate, especially of indirect and cross-subsidies, is available. The need for keeping down the expenditure on account of these subsidies has been emphasised time and again. The essential point to recognise is that subsidies introduce a distortion in the economy. Flow of resource is directed away from sectors to which they would have normally been applied. It is not to suggest that all subsidies are *per se* wrong. But it is very important to scrutinise to whom the benefits are really flowing. Each type of subsidy needs to be carefully reviewed from the point of view of overall impact on the economy and consideration of growth with social justice.

10.7.33 It is necessary that a comprehensive paper on direct, indirect and cross-subsidies, covering both Union and State Governments, is prepared by the Planning Commission every year and brought up before NEDC for discussion since the increasing burden of subsidies has a direct relevance to the availability of resources for the execution of the Plan.

UNION'S EXPENDITURE ON STATE SUBJECTS

10.7.34 It has been pointed out that the Union Government incurs a lot of expenditure on maintaining establishments and on schemes relating to subjects which fall in the States List or the Concurrent List of the Seventh Schedule, e.g., Agriculture, Rural Development, Cooperation, Education, Health, etc. Bulk of such expenditure is channelised through the Centrally Sponsored Schemes either as grants or loans. In case of many schemes, the Union and the States share the expenditures. We have taken note of a study[37] which has tried to project the issue empirically by showing that very high expenditure is being incurred by the Union Government, directly or through Central institutions, on Centrally Sponsored Schemes in violation of directives of the NDC in this regard, on subjects which belong to the States. We have dealt with various aspects of Centrally Sponsored Schemes in the chapters on Economic and Social Planning and Agriculture.

8. ROLE OF THE FINANCE COMMISSION

CONSTITUTIONAL PROVISIONS AND EVOLUTION

10.8.01 We have earlier noted the inevitability of substantial transfer of resources from the Union to the States. Another important aspect is the allocation of the resources so transferred among the States with wide differentials in fiscal capabilities and needs. The Constitution provides for the setting up of a Finance Commission periodically for this purpose. Article 280(1) enjoins on the President to constitute a Finance Commission, within two years of the commencement of the Constitution and, then after, at the expiration of every fifth year or before, if it is considered necessary. Clause (2) of that Article empowers Parliament to determine by law the requisite qualifications of its members and the manner of their selection. Clause (3) of the same Article enumerates the duties of the Finance Commission. It reads as under:

'(3) It shall be the duty of the Commission to make recommendations to the President as to -

(a) the distribution between the Union and the States of the net proceeds of taxes which are to be, or may be, divided between them under this Chapter and the allocation between the States of respective shares of such proceeds;
(b) the principles which should govern the grants-in-aid of the revenues of the States out of the Consolidated Fund of India;
(c) any other matter referred to the Commission by the President in the interests of sound finance'.

10.8.02 It would be pertinent to consider broadly the position in this regard in some of the other federations in the world. In USA and Canada the idea of an independent or regular agency for this purpose did not find acceptance. The Australian Commonwealth Grants Commission is an advisory body established by an Act of Parliament and recommends on special grants to the claimant States or on any other issue referred to it by the federal government.

37 George, K.K. and Gulati, I.S. - 'Central Inroads into State Subjects: An Analysis of Economic Services', *Economic and Political Weekly*, Vol. II (XV), No. 14, April 6, 1985, Pp. 592-603.

10.8.03 In the absence of a well laid down and constitutionally recognised institutional mechanism for revenue-sharing between the federal and unit Governments, in some of the countries numerous adjustments had to be resorted to. In the first place, because of concurrent taxation, in countries like USA, Canada and Australia, 'which level uses what kind of tax and to what extent has been decided more by custom and negotiation, embodied in statute or agreement, than by constitutional provision'.[38] In USA, the tax system which came to be developed over the years is described to be 'uncoordinated and overlapping'.[39] In Canada, recourse had to be taken to elaborate tax-rental arrangements. In Australia, at least in the initial years, the interests of the poorer states suffered. Even in West Germany, the constitutional provision specifying the shares of the Länder (States) and Local governments, came to be incorporated between 1955 and 1967 after facing serious problems.

10.8.04 The processes of inter-governmental transfers in other federations, besides other problems, are often intricately linked with political understanding and have given rise to controversies. For example, in USA, federal grants are based on agreements enforcing strict conditionality on the States and Local governments. The shift towards general grants in 1982, accompanied by substantial overall cuts is understood to have created serious problems for the States to implement social programmes. In Canada, the policy of revenue equalisation grants has always been politically controversial. The trend towards 'provincialisation' of federal funds is said to have reduced the ability of federal government to redistribute financial resources and has brought up the question of national standards. In Australia, the Commonwealth Grants Commission recommends special purpose grants to the claimant States, but the general grants are determined largely on the basis of discussions at the political level. In West Germany, the problem of matching the revenues and needs of the poorer States is sought to be solved through vertical and horizontal equalisation payments and inter-governmental grants and subsidies for special and joint projects.

10.8.05 The Finance Commission in India, in contrast, because of its constitutional status, constitutes as unique arrangement. The framers of the Constitution by building it into the Constitution and by making it an expert body, removed the devolution of resources from the arena of political bargaining. The role assigned by the Constitution to the Commission has been deliberately given an advisory character. In a technical sense its recommendations are not definitive or self-executing. Parliament has been given the supreme authority to oversee the action taken by the Union Executive on the recommendations of the Commission. This has been ensured by requiring the Union Government to place before each house of Parliament every recommendation made by the Finance Commission, together with an explanatory memorandum as to the action taken thereon.

ISSUES

10.8.06 The constitutional status accorded to it and its functioning as a semi-judicial expert body has earned for the Finance Commission high regard of the Union and State Governments. However, some aspects of the working of the arrangements have attracted criticism. This criticism may be classified into four categories:

(i) Deficiencies in the institutional arrangements envisaged in the Constitution.
(ii) Constraints imposed by the Union on the Finance Commission by prescribing certain terms of reference.
(iii) Non-implementation of important recommendations of the Finance Commission by the Union Government.
(iv) Problems arising out of the methodologies followed by the Finance Commissions.

38 Advisory Commission on Inter-governmental Relations, USA - *Studies in Comparative Federalism: Australia, Canada, the United States and West Germany* (1981), p. 43.
39 *Ibid*, p. 42.

10.8.07 While many State Governments are of the view that the existing institutional arrangements are adequate, some of them desire that its functions should be enlarged. Some of them have drawn attention to the fact that since Finance Commissions are established periodically, their approach has been inevitably somewhat *ad hoc* and there has been lack of continuity from one Commission to another. They have suggested a more permanent set-up. The various suggestions could be broadly classified as under:

(a) The functions of the Finance Commission be enlarged. It should also consider Plan and other transfers and/or undertake comprehensive annual/periodical reviews of the financial performance of the Union and State governments.

(b) The Finance Commission should be made a permanent or standing body to cope with enlarged responsibilities.

(c) The coordination between the Finance Commission and Planning Commission is very important and should be improved, so that an integrated view on the flow of Central assistance to the States becomes possible.

(d) It should be provided with a permanent and well-equipped secretariat to carry on studies and maintain operational continuity for the benefit of the subsequent Finance Commission.

10.8.08 The Finance Commission's recommendations generally remain effective for a period of five years. Many changes take place during the period in the estimates made by the Finance Commission at the beginning. Some of the State Governments have drawn attention to the fact that their financial position is adversely affected by inflation and various actions of the Union during this period. There is at present no mechanism to take care of the impact of these changes and provide relief.

10.8.09 It is argued that only one agency should deal with all the transfers, as the present dichotomy between plan and non-plan transfers is unnecessary and creates avoidable problems arising from differences in estimates and norms. Since the Finance Commission is the only institutional mechanism envisaged by the Constitution to recommend devolutions in all aspects it would be but appropriate that it should deal with the problems in their entirety. Another suggestion is that the two bodies should be merged.

ENLARGEMENT OF FUNCTIONS

10.8.10 There has been some divergence of opinion as to whether the jurisdiction of the Finance Commission under Article 275(1) is limited to grants on revenue account, and capital grants needed to meet expenditure on Plan schemes are outside its purview. The First Finance Commission was of the opinion that this problem has to be considered 'in the larger perspective of ensuring an equitable allocation of resources among the units'. On this broad premise, the Commission recommended special grants-in-aid to eight States for development of primary education. The Second Finance Commission took a different view. In its opinion, there was no scope under Article 275(1) for special purpose grants for removal of inequalities in the standards of basic social services in States and that this function in a planned economy belonged to the Planning Commission and the National Development Council. The Third Finance Commission took a view similar to that of the First regarding the broad scope of Article 275 and recommended 'special grants' to ten States for development of communications.

10.8.11 The issue was clinched by the Fourth Finance Commission when it observed:

> The Constitution does not make any distinction between plan and non-plan expenditure, and it is not unconstitutional for the Finance Commission to go into the whole question of the total revenue expenditure of the States. It has been pointed out to us that the reference to 'Capital and recurring sums' in the first proviso to article 275(1) of the Constitution suggests that even capital expenditure need not necessarily be outside the scope of the Finance Commission. It is, however, necessary to note that the importance of planned economic development is so great and its implementation so essential that there should not be any division of

responsibility in regard to any element of plan expenditure. The Planning Commission has been specially constituted for advising the Government of India and the State Governments in this regard. It would not be appropriate for the Finance Commission to take upon itself the task of dealing with the States' new plan expenditure.[40]

10.8.12 The Fifth Finance Commission also held that in the language of Article 275, 'there is nothing to exclude from its purview grants for meeting revenue expenditure on Plan schemes, nor is there any explicit bar against grants for capital purposes'. However, its terms of reference required it not to take into account the Plan for purposes of recommending grants-in-aid under Article 275. It did not even agree to recommend grants for higher expenditure outside the Plan on specific social services for improving their levels 'as it would blur the entire division of functions between this Commission and the Planning Commission'.[41]

10.8.13 One of the terms of reference of the Sixth Finance Commission enjoined it to assess the non-Plan capital gap of the States for the period 1974-75 to 1978-79. Adopting a pragmatic approach, the Commission described 'the separation of revenue from capital expenditure and of non-plan from plan expenditure' in re-assessment of States' forecasts as one of the 'ground rules'.[42]

10.8.14 The approaches of the Seventh and the Eighth Finance Commission marked a significant departure from the earlier one. They recommended some capital grants for the upgradation of levels of administration. The Eighth Finance Commission, recommended capital grants in Health and Education sectors, which are included among developmental sectors, treating them as essential non-plan earmarked capital requirements of the less-developed States. These recommendations were accepted by the Government of India. The observations of the Seventh Finance Commission on the issue need mention:

'We have given careful consideration to the scope for grants-in-aid under Article 275 for meeting capital expenditure. The operative part of this Article speaks of 'sums'. There is no restriction or bar in the Article for capital expenditure. The first proviso of the Article expressly speaks of grants of capital sums. This goes to show that the expression grants-in-aid of revenues does not limit grants for revenue expenditure only. We are fortified in this view by the note of the Chairman of the Fourth Finance Commission appended to its report on the interpretation of Article 275. Further, it seems unreasonable to hold that the operative part of the Article enables the Commission to make grants for revenue expenditure only, while the proviso enables grants being made of revenues as well as (of) capital nature. It is quite clear therefrom that it is open to us to recommend grants for capital expenditure also, apart from grants for revenue expenditure under Article 275'.[43]

10.8.15 The Union Ministry of Finance in response to a query on this issue, has provided the following clarification:

'It is settled policy of the Commission to cover the capital requirements of the States under the upgradation grants. In case the Commission on Centre-State Relations is alluding to the entire range of the capital requirements of the States during the forecast period, the roles of the Finance Commission and the Planning Commission in that case will overlap. The Planning Commission which is primarily concerned with asset-creation is given the near-exclusive responsibility for catering to the capital requirements of the States by the mechanism of Plan assistance for the 5-year plans. The

40 *Report of the Finance Commission*, 1965, para 16, p. 9.
41 *Report of the Finance Commission*, 1969, para 2.9, p. 12.
42 *Report of the Finance Commission*, 1973, Chapter IX, para 1, p. 29.
43 *Report of the Finance Commission*, 1978, Chapter 10, para 8, Pp. 93-94.

Finance Commission takes care of the capital requirements of States in non-developmental sectors by way of upgradation grants...... It may thus be seen that even in recent years the Finance Commissions have imaginatively and progressively made use of Article 275 grants both for capital and revenue and both for developmental and non-developmental purposes. This is notwithstanding the fact that the Presidential Order of the Eighth Finance Commission refers to upgradation requirements of non-developmental sectors only'.

10.8.16 Finance Commission is constituted periodically and works for a short period. Planning is a dynamic process and as such continuous appraisal and adjustments are essential. A static five-year frame would not meet the requirements of planning. The Planning Commission reviews annually the resources and plan needs of the States and recommends plan assistance. In a dynamic situation, net resources available for transfer from the Union to the States towards Plan assistance will also be known only on a yearly basis. The necessary expertise, support and competence for dealing with such a situation has been developed by the Planning Commission. For obvious reasons, it would not be possible for the Finance Commission to perform such a role. Therefore, practical difficulties would arise if Plan transfers are also entrusted to the Finance Commission. The present division of labour which has developed over the years is that the Finance Commission advisers on the non-Plan revenue requirements and non-Plan capital gap. In certain sectors, where the problem is clear and the numbers are reasonably sure, the Finance Commission has recommended capital resource devolution also only to a limited extent.

10.8.17 We are of the view that the present division of responsibilities between the two bodies, which has come to be evolved with mutual understanding of their comparative advantage in dealing with various matters in their respective spheres, should continue. The present arrangements have also not given rise to any serious problems to necessitate any change.

COORDINATION BETWEEN FINANCE COMMISSION AND PLANNING COMMISSION

10.8.18 Need for greater coordination between the Finance Commission and the Planning Commission has been emphasised by many State Governments and experts. The Administrative Reforms Commission had recommended that in order to ensure greater coordination between the two bodies, one Member of the Planning Commission should also be nominated as Member of the Finance Commission. Since the Sixth Finance Commission, one Member is common to both the Commissions. It is, however, a matter of concern that only two of the four common Members so far appointed were in charge of the Financial Resources Division in the Planning Commission. As this defeats the very purpose of having a common Member, we would suggest that the Member in-charge of financial resources in the Planning Commission should automatically be the common Member and remain in this charge even after the report of the Finance Commission is submitted. This arrangement would enable the adoption of an integrated approach in the assessment of financial resources and needs of the States by the two Commissions.

10.8.19 A precondition for smooth coordination between the two bodies is the synchronisation of Five Year Plan period with the reference period of the Finance Commission. There is an impression that once the Finance Commission's report is submitted, it is not of much consequence beyond determining major parameters like tax shares, grants-in-aid, etc. A planned economy presupposes utmost financial discipline. The entire system of resource transfer built up on the basis of the recommendations of a semi-judicial body of experts would crumble in case there is scant regard for the norms evolved by it.

10.8.20 We have already noted that Finance Commissions re-assess the receipts and expenditure of the States on a normative basis. A perusal of the reports of the various Finance Commissions shows that practically all the Finance Commissions have had occasion to note that on the receipts side the norms determined by the preceding

Finance Commission were seldom reached, particularly in regard to returns from irrigation and power projects and from State Road Transport Corporations. On the other hand, on the expenditure side, the norms have been invariably exceeded. In many cases, large expenditure on new non-Plan items has been incurred. Sometimes schemes which could not be accommodated in the Plan have been included as non-Plan items and large sums spent on them. Finance Commissions build into their forecasts of expenditure certain amounts for maintenance of assets already created, e.g., irrigation schemes, buildings, roads, etc. Often the amounts intended for maintenance of these assets have been diverted for other uses with very adverse impact on the upkeep of assets already created.

10.8.21 Finance Commissions have determined norms of returns from the irrigation schemes, State Electricity Boards and Road Transport Corporations. One of the terms of reference to the Sixth Finance Commission was to have regard, while determining the grants-in-aid, to 'the scope for better fiscal management and economy consistent with efficiency which may be effected by the States in their administrative, maintenance, developmental and other expenditure'. It observed that 'with the increasing investments in irrigation and power projects and road transport undertakings, non-tax revenues in the form of interest receipts and dividends should be expected to become increasingly important in State finances.'[44] After detailed consideration of irrigation schemes it reached the conclusion that in the case of multipurpose river valley projects and commercial irrigation, the receipts should cover the working expenses. However, this was not achieved. The Seventh Finance Commission, while reviewing the same, observed that working expenses continued to exceed the receipts and that 'complacency in this regard would be harmful and unjustified'.[45] The Eighth Finance Commission also observed that the norms evolved by the Seventh Finance Commission had not been met by the State Governments.[46] The position is similar in the case of State Electricity Boards and Road Transport Corporations.

10.8.22 We are of the view that these raise very serious questions in regard to fiscal management and financial discipline. In a situation of severe overall financial constraint, it is imperative that in-efficiency and imprudence in fiscal management is discouraged by evolving suitable procedures and systems of reward and punishment. We would emphasise that each Finance Commission should view with greater concern the violation of the regimen given by the preceding Commission and thus try to enforce a stricter discipline in checking wasteful expenditure.

10.8.23 The Finance Commission Cell/Division in the Planning Commission should continuously monitor the behaviour of the States' finances. It should also estimate annually the deviations from the norms evolved by the Finance Commission. The Planning Commission would then be able to bring up before the national Economic and Development Council such annual reviews indicating, among other things, the deviations from the forecasts of Finance Commission and the reasons for the same. This would afford an opportunity to the National Economic and Development Council to monitor effectively and evolve consensus on the mobilisation of resources and contain the non-developmental expenditure.

10.8.24 The Sixth Finance Commission observed: 'Fiscal management is a multidimensional concept. In the application of this concept to concrete situations, both qualitative and quantitative aspects deserve attention. Briefly stated, in assessing sound fiscal management one should have regard both to the manner in which the State has endeavoured to raise the resources needed for meeting its commitments and also the manner in which it has deployed the resources so raised so as to get the best possible results for the

44 *Report of the Finance Commission*, 1973, Chapter XII, para 4, p. 53.
45 *Report of the Finance Commission*, 1978, Chapter 2, para 44, p. 23.
46 *Report of the Eighth Finance Commission*, 1984, para 3.17(V), p. 14.

expenditure incurred. A review of fiscal management in this broad sense will call for a comprehensive and critical survey of the fiscal policies and administration of State Governments over a period of time. This is a task which is too difficult to undertake within the limited time at our disposal'.[47]

10.8.25 During the interregnum between one Finance Commission and the appointment of the next Commission, the Finance Commission Division (reinforced as suggested in paragraph 10.8.30) should, in cooperation with the States, organise comprehensive studies in trends in growth of public expenditure in the States in the light of the findings of the previous Finance Commission. It shall also collect, study and analyse the data with reference to the relevant parameters which would help a more critical appraisal of the achievements and failings of the States in the fiscal sphere. The studies conducted by the Finance Commission Division should be available well in time for the use of the next Finance Commission. This Division can also, with the cooperation of the Union Ministries and agencies under their control, arrange similar review of the expenditure of the Union Government. Professional institutes, organisations and Universities aided by Union Government funds, can also be involved in such studies.

PERMANENT FINANCE COMMISSION, ITS SECRETARIAT/DIVISION

10.8.26 Finance Commission has to deal with complex issues and the time available to it for the same is barely sufficient. Much of its time now spent on gathering data could be saved, if data collection is carried out on a continuing basis. Studies which may take time could also be organised in advance so that these are available to the subsequent Commissions and consideration of important matters would not be constrained for want of time. Two considerations are pertinent in this connection. Firstly, the Finance Commission is essentially an expert recommendatory body and cannot be expected to participate in active determination of the transfers on annual basis corresponding to changes in the economic situation. Indeed, the very scheduling of such exercises in an annual setting may be quite cumbersome and reopen a whole host of issues for consideration every year. Secondly, a measure of stability is desirable in the transfers and frequent changes may be very unsettling and counter-productive, giving rise to avoidable friction in Union-State financial relations. We are, therefore, of the view that there is no need for a permanent Finance Commission.

10.8.27 The next question for consideration is whether it is possible to mitigate the difficulties and handicaps of a Finance Commission resulting from its periodic constitution with new members, in assessing the fiscal needs of the States, projected over the next five-year period. The Seventh Finance Commission had observed: 'The position which prevails now is that once a Commission completes its work, a small and ineffective cell comes into being in the Union Ministry of Finance, and this cell is merged in the Secretariat of the next Commission. This arrangement, in our view, is inadequate. We do, however, feel that it will be extremely useful to future Finance Commissions and greatly facilitate their work, if an expert non-political agency were to be established by the Central Government and were to perform such functions as the Secretariat of the Commission is expected to perform. In addition, it would be expected to play a watching and advisory role with regard to Centre-State financial relations generally. As and when a full-fledged Finance Commission is appointed, this agency could get merged into the Commission and its Secretariat. It should have the authority to call for whatever information may be required from the Central and State Governments and their institutions and should analyse and prepare the data based upon which a Finance Commission when appointed can act without further loss of time. It should carefully oversee the implementation of the recommendations of a Finance Commission as accepted by the Central

47 *Report of the Finance Commission*, 1973, Chapter XIII, para 1, p. 52.

Government and its advice should be sought by the various Ministries of the Central Government on matters which may require follow-up action'.[48]

10.8.28 The Eighth Finance Commission also observed:

.... we do think that there should be a permanent Secretariat which should continue to function during the interregnum between one Commission and the next. Such a Secretariat should be headed by a senior officer, and may function as a Division in the Ministry of Finance. We are not satisfied by the present arrangement under which a small Cell consisting of a few officials functions as a part of the Ministry of Finance.[49]

10.8.29 We have been informed that in pursuance of the recommendations of the Eighth Finance Commission, a Finance Commission Division has since been created in the Union Ministry of Finance with the following functions:

(i) Continuously update the data, both in financial and physical terms relating to performance of the Union and each of the State Governments in fields which have been or could be of interest to the work ordinarily assigned to the Finance Commission;
(ii) Compilation of data and analysis of the working of the State undertakings including irrigation schemes to see whether the prescribed norms are being achieved and to suggest remedial measures;
(iii) To prepare analytical studies on the basis of the data collected from the State Governments regarding revenues, expenditure and prepare comprehensive reviews;
(iv) Re-scheduling and consolidation of loans on the basis of the Finance Commission's recommendations;
(v) Allocation of additional grants to States for meeting interest liability in respect of fresh loans advances;
(vi) Allocation of additional grants in respect of committed liability for the new schemes taken up in 1984-85;
(vii) To monitor and evaluate the utilisation of the upgradation grants provided by the Finance Commission to States;
(viii) Collection of data about non-developmental sectors for preparation of comprehensive proposals for achieving equalisation of the standards of administration and social services in States within a definite period;
(ix) Organisation of suitable training workshops for the benefit of States which may be in need of such assistance.

10.8.30 We are of the opinion that there is need to further strengthen the Finance Commission Division. It would result in much closer coordination between the Planning Commission and the Finance Commission if this Division were to work under the general supervision of the Member in-charge of financial resources in the Planning Commission. Such an arrangement will also make available to the Planning Commission data and analysis on various parameters relevant for resources discussion for the Plan and reviewing of the finances of the Union and the States.

COMPOSITION OF FINANCE COMMISSION

10.8.31 Article 280(1) requires the President to constitute by order a Finance Commission within specified time-frame, comprising a Chairman and four other members. Clause (2) of Article leaves it to Parliament to determine by law the requisite qualifications of the Members and the manner of their selection. Parliament enacted the 'Finance Commission (Miscellaneous Provisions) Act, 1951'.

10.8.32 No serious objection has come to our notice regarding the composition of the various Finance Commissions. A review of the composition of the nine Finance Commissions confirms that the prescribed strength, requisite

48 *Report of the Finance Commission*, 1978, Chapter 12, para 4, p. 119.
49 *Report of the Eighth Finance Commission*, 1984, para 16.11, p. 123.

specialisations and background of their Members and time-limit in their constitution were duly adhered to.

10.8.33 A suggestion has, however, been made that the State Governments should have representatives on the Finance Commission. One of the suggestions (not recommendation) of the Expert Committee on Financial Provisions of the Constitution (1947) was that two of the Members of the Finance Commission be selected out of a panel of names from the States. Further, the appointment of the Chairman and Members of the Commission should be made by the President in his discretion as the Committee anticipated that the Commission would be required to deal with points of conflict between the Union and the State Governments. This was not accepted by the framers of the Constitution. This suggestion arises out of an apprehension that the States' case may go by default unless they are represented on the Finance Commission. The record of the Finance Commissions, which have been known to be non-partisan, clearly shows that there is no basis for any anxiety on this score. We are, therefore, of the view that there is no need for any changes in the present arrangements in regard to the constitution of the Finance Commission.

10.8.34 Finance Commissions should draw from all over the country experts for assisting them in their work. Considerable amount of talent and expertise in regard to Union-State financial relations is in the States. It would be advantageous if suitable experts are drawn from the States also for staffing the Secretariat of the Finance Commission.

10.8.35 The broad duties of Finance Commission have been enumerated in Article 280 of the Constitution. Over the years, a number of special terms under sub-clause (3)(c) of Article 280 and some 'special considerations' come to be included in the Presidential Order. Although the Presidential Order appointing the Finance Commission and specifying its terms of reference is drafted by the Union Government, some of the States in the past are understood to have voluntarily suggested to the Union Government important matters which the Finance Commission should look into. In the context of the Seventh and the Eighth Finance Commissions, a more systematic consultation with the States on their terms of reference took place. The then Union Finance Minister invited suggestions from all the Chief Ministers in regard to the terms of reference for the Seventh Finance Commission. An official-level Committee formed in the Union Ministry of Finance to formulate the terms of reference considered, among other things, the replies received from the States. In the case of the Eighth Finance Commission, while no suggestions were invited from the State Chief Ministers on 'terms of reference', an official-level Committee under the Union Expenditure Secretary was set up on which some State Governments were represented. The same procedure was followed in the case of the Ninth Finance Commission.

10.8.36 The step taken by the Union Government to initiate a process of consultation with the States in finalising the terms of reference of the Finance Commission is in the right direction. Any consultation to be meaningful should be adequate. However, we do not see any advantage in formalising the same through a change in the constitutional provisions which would introduce undue rigidity. Nonetheless, it is desirable that this healthy practice of informal consultation with the States in this matter should continue.

SPECIAL CONSIDERATIONS

10.8.37 Another criticism relates to the 'considerations' which the Finance Commissions are asked to have regard to, among other things, in recommending grants-in-aid under Article 275. These are in addition to the special terms of reference as per sub-clause (3)(c) of Article 280. These 'considerations', it is alleged, have conditioned the methodology of the Finance Commissions.

10.8.38 In making recommendations, the Finance Commissions have been asked to have due regard, among other things, to certain 'considerations'. To illustrate, the Sixth Finance Commission was required to consider the requirements of States' backwardness in general administration with a view to raising the levels to those of the advanced States over a period of ten years. Similarly, some of the 'considerations' listed for the Seventh Finance Commission were:

(i) the resources of the Central Government and the demands thereon on account of expenditure on civil administration, defence, border security, debt-servicing and other committed expenditure or liabilities;

(ii) adequate maintenance and upkeep of capital assets and of completed plan schemes as on a specified year and monitoring of such expenditure; and

(iii) the need for ensuring reasonable returns on investments in irrigation and power projects, transport undertakings, industrial and commercial enterprises and the like.[50]

In the Presidential Orders constituting both the Seventh and Eight Finance Commissions it was stated that 'the Commission shall adopt the population figures of 1971 census in all cases where population is regarded as a factor for determination of devolution of taxes and duties and grants-in-aid'.

10.8.39 On this issue, the Union Government has communicated to us that the Finance Commissions are free to make recommendations on matters covered by Article 280, in any manner they deem fit. The Presidential Order in all these cases states that the Finance Commissions shall 'among other things' have regard to the listed considerations. These considerations are, therefore, to be viewed as 'an illustrative list of the factors considered germane by the Government to the task of the Finance Commissions'. The Union Government has observed that the stipulation that the population figures of 1971 census should be adopted wherever population is used as a factor in making recommendations for either devolution of taxes or grants-in-aid is in keeping with the Family Welfare Policy approved by Parliament on June 29, 1977.

10.8.40 Finance Commissions have enunciated from the very beginning considerations to be kept in view by them while determining the grants-in-aid, e.g., fiscal needs, considerations of equity in resource allocation among the States, etc. They have also taken into account, while assessing the fiscal needs, the considerations listed in the Presidential Order. But these conditions, have not by themselves restricted their approach. In fact, the Seventh Finance Commission observed: 'The Commission's freedom to take into account other factors is not inhibited'.[51] We note that a controversy has arisen in regard to the terms of reference of the recently constituted Ninth Finance Commission, particularly on para 4 of the Presidential Order which, it is alleged, binds it to follow a 'normative approach' and to take into account certain other aspects. In view of the reasons already stated by us in the preceding paragraphs, we are not convinced that any reference to Finance Commission unless constituting a term of reference *vide* Article 280(3) of the Constitution, can bind or delimit its approach. However, it will only be appropriate and befitting the statutory and high status of the Finance Commission that any considerations suggested to it, besides its terms of reference under Article 280(3), are put in a language which does not give an impression of formally binding it to adhere to a given approach or methodology.

10.8.41 The review made above clearly shows that from the practical angle the listing of various terms of reference and 'considerations' only facilitate the work of Finance Commissions. They are, indeed, found to be reasonable, in the interests of equity and social justice. We have noted that the Finance Commissions have made recommendations in regard to various matters enumerated in the terms of reference as well as some others. It would thus appear that the objections are more on the theoretical plane. We are, therefore, of the view that the existing procedure has considerable merit in focussing the attention of the Commission on important problems faced by the States, and may continue.

50 *Report of the Finance Commission*, 1978, Introduction, para 5, p. 2.
51 *Report of the Finance Commission*, 1978, Chapter 9, para 4, p. 76.

EFFECTIVENESS OF THE MECHANISM

10.8.42 Several of the less-developed and middle income group States have drawn our attention to what is called the 'gap-filling approach' of the Finance Commission. This approach implies that the revenue deficits which remain after determining and setting off the tax-shares of individual States are covered by the Commission through grants-in-aid. It is argued that the adoption of such an approach, in essence, has led to the phenomenon of huge surpluses with some of the more-developed States after devolutions and slender or zero surpluses with the others. On the other hand, according to one of the advanced States, the highly 'progressive' formulae of distribution of tax-shares followed by the Finance Commissions, entirely benefit the Union by minimising its total burden of devolution at the cost of revenue-surplus States. Further, such formulae also do not benefit the deficit States fully as their deficits persist even after tax devolutions, though at a somewhat reduced scale. Moreover, the norms adopted by the Finance Commissions in re-assessing revenue and expenditure forecasts do not obtain in reality, *inter alia,* on account of inflation and emergence of unforeseen situations. It is argued that in such a situation, with expenditures building up faster, the States receiving Article 275 grants to make up revenue account deficits are the first to be adversely affected followed by other less-developed States.

10.8.43 It is for the future Finance Commissions to go into the details and merits and demerits of the methodologies followed by the previous Finance Commissions and to suggest improvements therein. There has been a discernible trend towards refinement in the methodologies of the successive Finance Commissions. However, it may be necessary to go into the broad causes of dissatisfaction so far as the role of the Finance Commission is concerned.

10.8.44 The most important parameter estimated by the Finance Commissions is the non-Plan revenue gap/surplus of the States. It is arrived at by re-assessing tax and non-tax revenue forecasts of the States and deducting from them the non-developmental and non-Plan developmental expenditures. In 'projecting the revenues, the rates of taxes and tariffs as obtaining in the base-year immediately prior to the period of the Finance Commission are taken into account, as specified in the Presidential Order setting out the terms of reference. By implication, additional resource mobilisation effected in the subsequent period through revision in rates of taxes and tariffs, better collection, etc., is deemed as resource available for financing the plan.

10.8.45 This approach adopted by the various Finance Commissions has been criticised on the following grounds:

(i) The more-developed States have a surplus on non-Plan revenue account on their own resources, before taking into account devolution of taxes. Given the heavy reliance on tax-shares, any devolution from the Finance Commission only adds further to their surpluses. These surpluses enable them to finance higher levels of expenditure, both Plan and non-Plan. In the case of the weaker States, they are heavily in deficit on their own resources. In the case of some of them the deficit persists even after devolution by the Finance Commissions through tax-shares. This deficit is made up by giving grants-in-aid to them leaving them in a situation of zero surplus. It has been argued that such a system is totally opposed to principles of equity which would, in fact, require that they be left with large surpluses. It has been observed that since revenue account has been balanced with the help of grants-in-aid, and grants-in-aid are fixed, the effect of inflation is to convert the zero surplus into a deficit.

(ii) The Finance Commissions have necessarily to adopt normative approach. The norms of receipts and expenditure adopted are stated to be unrealistic, particularly in the case of returns assumed from past investments on irrigation and power projects.

(iii) Specific grants have been given to States irrespective of whether they are, in deficit, or are enjoying a revenue surplus.

(iv) The 'gap-filling' approach of the Finance Commissions has induced financial indiscipline in the States. The critics suggest incorporation of some system of incentive and penalty corresponding to the quality of fiscal effort and management, in the absence of which the mechanism tends to become anomalous and iniquitous.

10.8.46 The Constitution provides that grants-in-aid of revenues charged on the Consolidated Fund of India in each year may be given to such States as are in need of assistance (Article 275(1)). The question as to which States are in such need, is determined by Parliament after considering the recommendations of the Finance Commission. The gap between the estimated expenditure on current administration and the revenues of a State after including the devolutions by way of tax-sharing, is taken by the Finance Commission as the 'need' of that State. This may not be a fool-proof method of assessing the need of a State, but there is no alternative except to improve upon it. Several imponderables complicate this process. The Finance Commissions have themselves been conscious of the infirmities of this method, that, *inter alia,* it tends to encourage unsound fiscal policies and wasteful expenditure on the part of a State. In his key-note address at a symposium in August, 1974, Dr. Brahmananda Reddy, an experienced statesman and Chairman of the Sixth Finance Commission, emphasised the difficulty of evolving infallible formulae for assessing the fiscal needs of the States, as follows:

> ..... a fool-proof scheme of grants-in-aid can be worked out only if Finance Commissions are able to evolve suitable yardsticks for adjudging the reasonableness of levels of public expenditure attained in several States. Finance Commissions have not been able to find satisfactory answers to such questions as whether there is evidence of over-staffing or other forms of wasteful and unproductive expenditure. It is not merely lack of time that inhibits a Finance Commission from embarking on such enquiries. Finance Commissions also possibly apprehend that they may be called upon to pronounce value judgements on issues of policy once they attempt a detailed analysis in qualitative terms of expenditure in different areas of administration. Finance Commissions are handicapped in probing public expenditure in depth in the absence of sufficient details on such matters as strength and disposition of staff and norms for assessing productivity of public expenditure. Audit reports highlight major irregularities, but they do not enable us to quantify the extent of economies consistent with efficiency that are possible.

According to the Seventh Finance Commission: 'Grants-in-aid may, in the first place, be given to States to enable them to cover fiscal gaps, if any, left after devolution of taxes and duties so as to enable them to maintain the levels of existing services in the manner considered desirable by us and built into their revenue forecasts'.[52]

10.8.47 No doubt various Finance Commissions have taken pains to enunciate rational principles taking into account fiscal needs, tax-efforts, equity, efficiency, etc. But much work remains to be done in regard to defining principles for determining relative fiscal needs, quantifying relative tax-potential, etc. In the absence of this, the importance of revenue gaps has stayed. We are of the view that serious attention should be given by future Finance Commissions to these aspects also.

10.8.48 The various Finance Commissions have been effecting refinements in the methodology, keeping in view the emerging situations and terms of reference. Some notable developments in this regard have been: the increase in the tax-shares of the States in the divisible pool, progressivity introduced in the criteria of allocation, consideration of States' non-Plan capital gaps, provision of grants for upgradation of levels of administration along with their monitoring, standardisation of arrangements regarding grants for natural calamities, and building 5 per cent annual increase in revenue gap grants and linking distribution of 5 per cent of the divisible proceeds of the Union Excise Duties with the assessed

52 *Report of the Finance Commission*, 1978, Chapter 9, para 5, p. 76.

revenue-deficits of the States. We note that the terms of reference of the recently constituted Ninth Finance Commission require it, *inter alia,* to adopt a normative approach in assessing the receipts and expenditure on the revenue account of the States and the Centre; have due regard to the need for providing adequate incentives for better resource mobilisation and financial discipline as well as closer linking of expenditure and revenue-raising decisions; take into account the need for speed, efficiency and effectiveness of Government functioning and of delivery systems for Government programmes; and keep in view the objective of not only balancing the receipts and expenditure on revenue account of both the States and the Centre, but also generating surpluses for capital investments. We hope that these terms of reference of the Ninth Finance Commission will help in evolving a more comprehensive and integrated approach and will ultimately result in providing the much needed financial discipline both in the States and at the Centre.

10.8.49 State Governments and experts have made various suggestions in regard to methodological improvements, e.g., regarding changes in criteria of devolution, incorporation of fiscal-needs approach in place of the alleged gap-filling approach, special provisions for the hill States in the devolution, etc. These are also the issues raised before successive Finance Commissions. We feel that such matters should appropriately be considered by the future Finance Commissions.

10.8.50 We cannot but emphasise two matters in this regard. Firstly, there is need to recognise that the less developed areas, would require greater attention than hitherto in the over-all interests of the nation. Even within a more advanced State, there are backward regions, which call for special attention. Secondly, it is imperative that the system of devolution encourages resource mobilisation, efficiency and cost-effectiveness in the application of the same. This aspect has assumed greater importance today than at any time before, owing to the emergence of a substantial resource crunch both in the Union and in the States.

STATE PLANNING AND FINANCE BOARDS

10.8.51 Consideration of adequate flow of funds to the backward regions in the States would necessitate creation of expert bodies like the Finance Commission at State level also. Without such an organisation at the State level to effect regional distribution, skewness will persist in large pockets even in an advanced State. In the chapter on Economic and Social Planning we have stated that the State Planning and Finance Boards suggested by us can, with advantage, take an objective view of resources to be devolved to the districts.

SUPPORT TO ADMINISTRATIVE CAPACITIES AND INFRASTRUCTURE

10.8.52 Another point which we would like to emphasise is the desirability of continuing the provisions for upgradation of administrative standards and maintenance of infra-structure and capital assets in the States. Since the Sixth Finance Commission, a process has been initiated to give grants for upgradation of levels of administrative/organisational support in backward areas (which) is a *sine qua non* for making the investment effective in consonance with the accepted policy of reducing regional disparities. As has been observed by the National Committee on the Development of Backward Areas, the present capacity of such States to absorb investment is a limiting factor for their long-run development. It may even be desirable to provide in the special terms of reference of the Finance Commission to make available finances, with effective monitoring arrangements, to fill up the inter-State gap in administrative capabilities. Otherwise also, we hope that the Finance Commissions will continue paying attention to this vital aspect.

TREATMENT OF THE FINANCE COMMISSION'S RECOMMENDATIONS

10.8.53 An important aspect connected with the role of the Finance Commission is the treatment accorded to its recommendations by the Union Government. By and large, the recommendations made by the Finance Commissions have been accepted by the Union Government. However, there have been three instances when the recommendations of the Finance Commissions were not accepted:

(i) The Third Finance Commission's recommendation for devolution, as part of Article 275 grants, towards 75 per cent of the revenue component of the Third Five-Year Plan was not accepted. The reason given by the Government was that no real advantage was seen in channelising grants for the same purpose from two different sources.

(ii) Two recommendations made by the Seventh Finance Commission were not accepted. They were:

(a) The loss equal to the difference between the amount of excise revenue realised on sale of potable liquor and that assumed by the Commission may be compensated by the Centre to the full extent.

(b) The small savings loan should be treated as 'loans in perpetuity'.

The former recommendation was not accepted on the ground that as prohibition was among the Directive Principles of State Policy, the State should also bear the loss. The Union Government's contribution was fixed at 50 per cent. In the case of the latter recommendation, the Government was not convinced of the logic given by the Commission and did not accept the recommendation. However, a decision was subsequently taken to postpone the recovery of these loans from the States for the period of the Finance Commission (1979-1984).

(iii) Recently, the final recommendations of the Eighth Finance Commission were not implemented during 1984-85, i.e., the first year of the Commission's period of reference, during which its Interim Recommendations remained in force.

10.8.54 It is this last instance which has been strongly protested against by several States, experts and others. It is alleged that, besides causing serious hardship to several States as their expectations for higher devolutions in that year were belied, this has also adversely affected the prestige of the Finance Commission. In view of the latter aspect, in particular, this case requires a review here.

10.8.55 The Union Government stated in the Explanatory Memorandum placed before Parliament that as four months of the financial year 1984-85 had already passed by which time the budget and annual plans were already finalised and were in operation, the implementation of the final recommendations would have caused 'undue disruption in the economy' if the budgets and the annual plans were then changed. In particular, it was stated that changes in the shares of taxes and duties, if effected at that stage, would have caused problems resulting in lower shares to some of the States.

10.8.56 Subsequently, in reply to a query on this issue, the Ministry of Finance gave following additional reasons for non-implementation of the final recommendations of the Eighth Finance Commission in 1984-85:

(i) If the Union Government had received the report of the Finance Commission in time, it would not have agreed to give to the States Central assistance towards the Annual Plan of the order made. The Central assistance was stepped up for the Annual Plan, involving additional transfers, of about Rs 790 crore over the balance left for the last year of the Sixth Plan. Further, a decision was taken to provide an extra assistance of Rs 499 crore to the States as medium-term loan to clear their overdrafts at the end of the financial year.

(ii) The recommendations of the Finance Commission, according to constitutional provisions 'do not constitute an award'. These are 'recommendations' to the President. Finance Commission is 'an aid to the administrative machinery'. The executive may or may not accept its recommendations considering their feasibility and desirability of implementation on objective considerations.

(iii) Finding additional resources to implement the final recommendations would have required unpleasant measures like additional taxation or deficit financing.

10.8.57 The above-mentioned reasons are to be evaluated in the light of the following facts:

(i) Presentation of the final report of a Finance Commission in the course of the financial year of its period of reference is not an unusual phenomenon. The Fifth Finance Commission presented its report on July 31, 1969; yet it was implemented from that very year.

(ii) The argument that the Union Government would not have released substantially high order of Central Plan assistance to the States if the final report had been available in time, cannot be a justification for non-implementation of the recommendations as the nature of the two transfers is different. Central plan assistance carries a heavy loan component whereas the devolutions through the Finance Commission are in the nature of tax-shares and grants.

(iii) While some of the States might have lost in the mid-year implementation of the report in terms of tax-shares, etc., corresponding loss to other States due to non-implementation was much larger.

(iv) The final report of the Commission was submitted on April 30, 1984 but was presented to Parliament only on July 24, 1984. The Budgets and Annual Plans for 1984-85 were prepared on the basis of the recommendations contained in the Interim Report of the Commission which were provisional in character. Nonetheless, there existed an expectation of more funds becoming available to the States during the course of the year.

(v) Assistance given on the basis of the Interim Report could be adjusted against dues based on the Final Report.

10.8.58 It is, indeed, unfortunate that the Eighth Finance Commission's final recommendations were not implemented in 1984-85 which caused serious financial problems to some States. Several State Governments have voiced protest in this connection before us. It has to be appreciated that non-implementation of Finance Commission's recommendations not only causes damage to its prestige but may give rise to serious friction in Union-State relations in future. We cannot but stress that while the recommendations of the Finance Commission are not binding on the Union Government in a technical sense, the expectation is that, as far as possible, these would not be departed from without compelling reasons. We hope that in future there would be no occasion for such departure. It is necessary that the time-schedule for the completion of the Finance Commission's work is so drawn up that it can reasonably submit its final report 4 to 5 months before the beginning of its period of operation. Such a step would also give the Union Government sufficient time to get the recommendations examined, place the Explanatory Memorandum before Parliament and make necessary budgetary provisions.

FINANCE COMMISSIONS' DATA AND OTHER OBSERVATIONS

10.8.59 We would like to mention two more aspects regarding the Finance Commissions which have been brought to our notice:

(i) During the course of its work the Finance Commission collects and processes massive statistical data and other information. This does not become available for research and analysis by the experts and research institutions and even to the Government departments generally. This indeed, is not a happy state of affairs. We understand that the Australian Commonwealth Grants Commission publishes the details of its calculations and the intermediate data for scrutiny of public and use by researchers. As much of the information gathered by the Finance Commission, as well as the detailed methodology followed by it, is (are) of public interest, we recommend that it should be got published, say within six months of the submission of the Report, to enable informed discussion and responsible research in the relevant spheres and better appreciation by the State Governments.

(ii) In addition to the matter specified in the terms of reference, the Finance Commissions make a number of other observations and suggestions which they deem important. Some of these suggestions are taken note of by the Government. We are of the view that it will be a healthy practice if these observations and suggestions are also considered expeditiously by the Union Government and a comprehensive statement placed before Parliament subsequently indicating its views and action taken.

9. SPECIFIC PROBLEMS AND INSTITUTIONS

10.9.01 We have already considered the general issues, trends and the arrangements in Union-State financial relations. We now consider a variety of specific problems which have been raised by the State Governments in the working of the arrangements. Firstly, there are allegations regarding restrictions on States' power of sales taxation, inadequate exploitation by the Union Government of the revenue heads under Articles 268 and 269, insufficient royalty on minerals and pressures on States' resources following revisions in pay-scales, rates of dearness allowance, etc. Secondly, some suggestions have been made for setting up institutions for consultations between the Union and the States on financial matters and for expenditure control. Finally are those problems arising in the day-to-day financial management, viz., regarding release of instalments of Central Plan assistance, natural calamities relief assistance, grants for upgradation of levels of administration, etc. The issues relating to indebtedness, market borrowings, rationalisation in the allocation of capital resources, the problem of overdrafts and flow of institutional finance have been discussed in Section 10.

CONSTRAINTS ON RESOURCE MOBILISATION
SALES TAXATION

10.9.02 The enactment of Central Sales Tax Act, 1956, while declaring a number of goods to be of special importance in inter-State trade or commerce, has also put restrictions on States' powers to impose any tax on the sale and purchase of such goods inside the State to 4 per cent (which is the current rate) of the price, and that too only at one stage of its transaction. This followed amendment of Articles 269 and 286. A State Government has suggested that the power of Parliament under Clause (3) of Article 286 should not be exercised without consulting the States. A regional party also has suggested omission of Entries 92A and 92B from the Union List with corresponding modification of Entry 54 of the State List.

10.9.03 We have already noted that Sales Tax is the single most important and elastic source of revenue to the States. Its share in States' own tax-revenue has increased from about one-fourth in 1951-52 to 56.9 in 1984-85. Arbitrary abridgement, if any, of States' powers in this regard, therefore, has to be viewed seriously.

10.9.04 In the Government of India Act, 1935, *vide* Entry 48 of List II, the Provincial Legislatures had powers to levy 'taxes on the sale of goods and advertisements'. By the time the Constitution came to be framed, a tendency on the part of the States was observed to tax goods in inter-State sale as internal sale leading to unregulated and multiple taxes on such goods which was burdensome both to the consumer and the trader. In the Constitution, therefore, certain restrictions were incorporated to meet this situation.

10.9.05 Article 286, prior to the Constitution (Sixth Amendment) Act, 1956, read as under:

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

10.9.06 Parliament had declared a number of goods as 'essential goods' *vide* Essential Goods (Declaration and Regulation of Tax on Sale or Purchase) Act, 1952, thus prohibiting the States from taxing them. The Taxation Enquiry Commission, 1953-54 which, among other things, also looked into the inter-State sales taxation and anomalies in the approach to sales-taxation, made recommendations which led to the Constitution (Sixth Amendment) Act, 1956. Union List (Entry 92A) and the State List (Entry 54) of the Seventh Schedule, Articles 286 and 269 were amended with the following effect:

(i) The States cannot impose, or authorise imposition of any tax on sale and purchase of goods outside the State or in the course of imports and exports of goods across the territory of India (Clause (1) Article 286).
(ii) Parliament acquired the power to levy taxes on inter-State sale or purchase of goods (*vide* Entry 92A, List I, Seventh Schedule).
(iii) The proceeds of inter-State taxation became assignable to the States (Article 269).
(iv) Parliament was empowered to formulate, by law, principles determining inter-State sale and purchase of goods and their import and export across the territory of the country (*vide* Clause (2), Article 286).
(v) Parliament was also given powers to declare goods which are of special importance in inter-State trade or commerce and subject to the States' powers of taxation in this respect to such restrictions and conditions in regard to the system of levy, rates and other incidence of the tax as Parliament may by law specify (*vide* Clause (3) Article 286).

10.9.07 On the recommendations of that Commission, the Central Sales Tax Act was passed in 1956, essentially to achieve a degree of uniformity in taxation of goods of special importance by the States. It enabled the Union Government to regulate taxation of goods of special importance by the States. The original limit of 1 per cent of States' Sales Tax, that too at single point, was raised to 2 per cent in 1958, 3 per cent in 1966 and 4 per cent in 1975. The list of the 'goods of special importance' was revised in 1976, and at present includes fifteen items (List of goods is given in Annexure X.16) (Not inserted).

10.9.08 As observed in the chapter on Legislative Relations, the constitutional amendments referred to above were necessitated due to noticed ambiguity as it stood originally in Clause (2) of Article 286 which had given rise to litigation. The arrangements as they stand today have several advantages. They are intended to prevent multiple taxation of the same transaction and thus keep the burden of taxes low on both consumers and producers of subsequent items. They facilitate maintaining of uniform rates of taxation of items declared as 'goods of special importance' with respect to which the powers of Parliament under Article 269 (Entry 33 of List III) were enhanced by the Essential Commodities Act, 1955. They have also sought to plug loopholes in the law and are in consonance with the spirit of Article 19(g). A more or less uniform rate of taxation of such items throughout the country and exercise of check in their taxation becoming too heavy on consumers and other users, are abundantly justified in terms of principles of equity and efficiency in the system. It is a matter of choice which the community as a whole has to make regarding the extent to which the essential goods need to be taxed but the need for uniformity cannot be disputed. Indeed, one of the objects of the 1956 Act was also to enable the State Governments to raise additional revenue from items then immune from taxation. Thus, while the Union Government levies sales tax on goods in inter-State trade, the proceeds are collected and retained by the States.

10.9.09 In view of the above considerations, we are of the view that the restrictions on the powers of the States to tax sales of specified goods cannot be regarded as arbitrary. Any other problems arising in this regard can be resolved by discussion in the proposed National Economic and Development Council or the Sub-Committee on Finance of its Standing Committee recommended by us later in paragraph 10.9.50. These could also be referred for expert advice to the Authority recommended by us to be set up under Article 307 (see para 8.4.05).

CONSIGNMENT TAX

10.9.10 A regional Party has suggested that Entry 92B should be deleted. We have considered in the chapter on Legislative Relations this demand. Any tax levied by the Union under Entry 92B is assignable to the States and apart from augmenting States' resources it will also help plug loopholes. We have, therefore, not supported the proposal for deletion of this Entry. Entry 92B of List I was inserted by the Forty-Sixth Amendment to the Constitution in 1982. Even though five years have elapsed, no legislation has been undertaken to give effect to the intent of the constitutional amendment. This has given rise to serious apprehensions. According to an estimate, the revenue realised from Consignment Tax during this period would have been in the range of rupees 2,000 to 4,000 crore per annum. The States have a legitimate grievance that they are losing substantial revenues on account of inaction or delay by the Union. Indeed, one State Government as strongly represented that due to delay in the levy of the Consignment Tax, it has lost substantial revenues - around rupees 100 crore every year. Inasmuch as the entire amount is assignable to the States, the Union is also laying itself open to the charge that precisely for this reason it is not showing sufficient interest in the levy of this tax.

10.9.11 The Union Government has pointed out that the basic decisions about levying the tax and the manner of allocation of its proceeds were taken by consensus in a Conference of Chief Ministers convened by the then Finance Minister as early as on May 28, 1984. When asked out the reasons for the delay in the imposition of the Consignment Tax, the Union Ministry of Finance has informed us in July 1986, as under:

'It was decided by the Conference, among other things, that power of exemption might vest only in the State Government. Subsequently, suggestions were received from various Ministries that it was essential that power of exemption might also vest concurrently with the Central Government along with the States. It was felt that the concurrent power of exemption would enable the Centre to have uniformity of taxation on goods and transactions of all-India importance throughout the country and also to avoid any marked fluctuations of the prices of the commodities of national importance and those which are subject to the scheme of administered prices. Accordingly, Finance Minister wrote to the Chief Ministers in this regard. Some States agreed to this suggestion while others opposed it. The matter is proposed to be placed before the Chief Ministers' Conference to be convened shortly by the Finance Minister'.

10.9.12 There are two aspects which should be kept in view. Firstly, the levy of Consignment Tax will help to plug loopholes and enable a better check on evasion of inter-State Sales Tax. Here, the rate of tax is not the important aspect, but the fact that even a low rate of tax will help in detecting the evasion. The other aspect is that this tax is a potential source for raising substantial revenues for the States. It is a matter of serious concern that even after a lapse of about five years no legislation has been brought in for giving effect to the intent of the constitutional amendment. By any reckoning, five years is long enough period sufficient for consultations with States and experts for formulating a Bill laying down the broad substantive guidelines, spelling out the methodology of levying the tax, delegating to the Union Executive authority to work out the details in regard to rate, etc., in accordance with the guidelines. We are of the firm view that the Union Government should bring in suitable legislation in this regard without further loss of time.

ADDITIONAL EXCISE DUTIES IN LIEU OF SALES TAX

10.9.13 Another area where allegations of Union Government's inroads into States' sphere of raising revenue are made is the replacement of States' Sales Tax by Additional Duties of Excise on selected commodities. This arrangement came into being after the consensus arrived at in the meeting of the National Development Council in 1956. Additional duties of excise in lieu of States' Sales Tax have since been implemented through the 'Additional Duties' of Excise (Goods of Special Importance) Act, 1957 covering mill-made textiles, sugar and tobacco including unmanufactured tobacco. The receipts on this account are distributed among the States on the recommendations of the Finance Commission. The major considerations which weighed in evolving such 'tax-rental' arrangement, as described by the Fourth Finance Commission, consisted of removal of administrative complexities and simplification of the structure of commodity taxation, preference indicated by trade, industry and consumers for excise taxation *vis-a-vis* sales tax, reduction in cost of collection and opportunities of evasion, and better collection and coordination keeping in view the total incidence of commodity taxation.

10.9.14 In their memorandum submitted to the Fourth and Fifth Finance Commissions, the State Governments complained that the receipts from additional excise duties were much lower than what they would have got if they had imposed sales tax on them. In pursuance of the recommendations made by the Fifth Finance Commission, the National Development Council in its meeting held on December 28, 1970, reviewed the arrangements and approved continuation of the scheme subject to:

(i) conversion of specific duties into *ad valorem* duties except in respect of unmanufactured tobacco;
(ii) the raising of the incidence of additional excise duties as a percentage value of clearance to 10.8 per cent 'in a period of two to three years'; and
(iii) achieving and maintenance of ratio of 2:1 between the yields of basic excise duties and the additional excise duties on these commodities.

10.9.15 A Standing Review Committee consisting of Central and State Government representatives was also constituted for reviewing the scheme. The Committee suggested that the rate of 10.8 per cent be reached in phases, viz., 8.5 per cent by 1984-85, 9.75 per cent by 1987-88 and 10.8 per cent, by 1989-90. It also suggested that the States should not insist on 2:1 ratio of basic to additional excise duties till the incidence of additional excise duties of 10.8 per cent (with a total incidence of 32.8 per cent) was reached. Further, it was recommended by the Review Committee that the level of incidence should not be allowed to go below 7.4 per cent in future years. The Eighth Finance Commission expressed the hope that the above recommendations of the Standing Review Committee would be implemented by the Union Government within the time schedule contemplated. In 1984-85, the assurance regarding achievement of the incidence of 8.5 per cent of the value of clearances in respect of the additional excise duties was reached. The incidence of additional excise duties for 1987-88 is estimated at 9.90 per cent as against 9.75 per cent recommended by the Standing Review Committee. We hope that the level of 10.8 per cent of the net value of clearance will also be realised as per schedule indicated by the Standing Review Committee.

10.9.16 On the recommendations of the Report of the Indirect Taxation Enquiry Committee, 1978 (Chairman: L.K. Jha), a proposal has already met with general approval of the Chief Ministers in their meeting in September, 1980 to extend the scheme of additional excise duties to five more commodities; (i) Vanaspati; (ii) Drugs and Medicines; (iii) Cement; (iv) Paper and Paper Boards; and (v) Petroleum products. Some of the State Governments have, however, expressed reservations about the proposed extension of the scheme.

10.9.17 This scheme of extension of Additional Duties of Excise was examined by an Expert Committee (Chairman: Kamlapati Tripathi) 1983, which, among other things, suggested formulae for distributing the revenue realisable by additional excise duties from the five commodities under the proposed scheme.

10.9.18 On a consideration of the arguments given by the State Governments against the arrangement of additional excise duties in lieu of sales-tax, it has been observed that the problem is not so much with the rationale or principles involved as for not raising the tax to the level accepted by the National Development Council. The State Governments, in view of the past experience, do not feel assured with the formulae suggested and that the recommendations made by the Tripathi Committee would be duly honoured. One State Government has mentioned that this has happened because the decisions of the National Development Council have no statutory backing and that the recommendations of the Tripathi Committee might meet with the same fate resulting in considerable loss to the State

Governments. Another State Government has challenged in the Supreme Court the provisions of the Constitution (Sixth Amendment) Act, 1957, Sections 10 and 11 of the Central Sales Tax (Second Amendment) Act, 1958 and Additional Duties of Excise (Goods of Special Importance) Act, 1957.

10.9.19 We note that whatever be the theoretical arguments in favour of levy of additional excise duties in lieu of Sales Tax, in practice, many problems have arisen. The experience of the States during the past decade, and more in regard to Additional Duties of Excise on mill-made textiles, sugar and tobacco, has given room for genuine apprehensions. Unless these misgivings are removed by devising a suitable formulae acceptable to the States, any extension of the scheme to additional commodities is likely to create quite an amount of Union-State friction. In view of the advantages of the scheme of Additional Excise Duties cited in para 10.9.13, we do not favour withdrawal of the present scheme as has been suggested by a State Government. We also note that the document on long Term Fiscal Policy has stated:

'Merger of additional excise in lieu of sales tax with basic excise duties, though desirable, is not feasible for the present as it would require evolving a suitable formula for allocating a part of the excise duties on textiles, tobacco and sugar for distribution among the States. The matter will be referred to the next Finance Commission for determination of a suitable formula'.[53]

We note that this matter has since been referred to the Ninth Finance Commission for examination.

SPECIAL CESSES/DUTIES IN EXCISE TAXATION

10.9.20 There have also been areas of inadequate understanding in the sphere of excise-taxation and sharing of its proceeds. State Governments have viewed with dissatisfaction the various types of special regulatory and auxiliary duties which were imposed by the Union Government to raise exclusive and additional revenues. These have gradually become sharable with the States. However, the yield from certain cesses levied through special Acts of Parliament have remained outside the sharable pool of resources. Such cesses and duties earmarked for special purpose constitute about 10 per cent of the gross proceeds of the Union Excise Duties. The Finance Commissions, including the last one, have treated them on a different footing from the other variants of Excise duties and have not considered it desirable to suggest their sharing with the States. In the *Long Term Fiscal Policy* (1985), it has been recognised that although the revenue from these cesses is earmarked for specific purposes, they contribute to the multiplicity of taxes and that the 'Government will endeavour to reduce the number of these cesses to the extent feasible.'

10.9.21 We recommend that while it may become necessary for the Union Government to levy cesses in view of the special needs, their application should be for limited durations and for specific purposes only.

ARTICLES 268 AND 269

10.9.22 Some State Governments have pointed out that the fields of taxation mentioned in Articles 268 and 269, particularly in the latter, should be better exploited. In Section 5 we have already dealt with the suggestions made by some of the State Governments and political parties involving constitutional changes with respect to powers to impose taxes enumerated in these Articles. Here we are concerned only with the allegation made regarding their inadequate exploitation by the Union Government thus depriving the States of the revenues assignable to them on their account.

ARTICLE 268

10.9.23 Article 268 relates to Stamp duties that are to be levied by the Union Government but collected and retained by the States. The scope for further mobilising revenues from various types of duties was examined by the Eighth

53 Government of India, Ministry of Finance - *Long Term Fiscal Policy, December 1985*, para 6.5, Pp. 36-37.

Finance Commission in consultation with the Reserve Bank of India, Department of Banking, the Life Insurance Corporation and other concerned institutions. Some scope for raising stamp duty on bills of lading, letters of credit and policies of insurance and proxies was considered feasible but in the absence of adequate data the Reserve Bank of India could not quantify the amounts. This matter has to be further pursued by the Government of India.

ARTICLE 269

10.9.24 Some State Governments have pointed out that the Union has not been taking steps to levy taxes covered by Article 269 and has thus deprived them of potential revenue. The Eighth Finance Commission considered the scope for raising revenues from the taxes and duties under Article 269 in pursuance of one of its terms of reference. A variety of problems in levying taxes and duties under Article 269 have been highlighted by the Commission. For example, although a majority of States favour levying of terminal taxes on goods or passengers carried by railway, sea or air, there are complex problems of detailed accounting, concurrent taxation by States on road transport, the need for maintaining a balance among the various modes, etc. Besides, meagre yields are estimated from these taxes and duties. Similarly, levying of a tax on railway freights on any considerable magnitude has to be considered against the odds of fuelling of inflation and the fact that the revenue yields may not be much, in case the essential goods and raw materials are reasonably exempted from such a tax. The nascent stage of development of stock exchanges in the country was reckoned as a weighty consideration by the Eighth Finance Commission for not favouring a tax on transactions in stock-exchanges; the expected yield from a tax on transactions in 'futures market' was also considered to be insignificant. Further, a tax on the sale of newspapers, it is feared, will severely hit their circulation and not be in the larger interests of the country. The Eighth Finance Commission, however, did find some scope in levying tax on advertisements published in newspapers and journals which according to the estimates of Ministry of Finance, may fetch a revenue of Rs 400 to 500 crore. Several States, however, favour exempting small newspapers from such a tax.

10.9.25 The scope for raising additional resources to any considerable extent on items covered by Article 269 would thus appear to have serious limitations. In fact, the opinions of the State Governments themselves are divided on the scope for levying these taxes and duties. It is necessary that the social and economic implications and administrative complexities are carefully gone into before any decisions are taken in this regard.

10.9.26 We are of the view that an expert committee should be constituted to enquire into, and review from time to time, in consultation with the States, the operational feasibility of the scope of levying such (Article 269) taxes and the complementary measures the State Governments would be required to take.

TAX ON ADVERTISEMENTS BROADCAST BY RADIO OR TELEVISION

10.9.27 A State Government has made the following suggestions:

'A tax on advertisements should be imposed and the scope of Article 269(1)(f) may be widened to include, besides newspaper advertisements, advertisements broadcast by radio or telecast by television'.

10.9.28 In paragraphs 10.9.24 and 10.9.25 above we have, *inter alia*, dealt with the scope for tax on advertisements published in the newspapers. States' power to levy tax on 'advertisements broadcast by radio or television was precluded in Entry 55, List II by the Constitution (Forty-second Amendment) Act, 1976 in addition to the already existing exception in that Entry of tax on 'advertisements published in the newspapers'. But, whereas the latter had a corresponding mention in Entry 92, List I and Article 269(1)(f), the subject of tax on 'advertisements broadcast by radio or television' was not provided in the above-mentioned Amendment Act. We have not been able to get a satisfactory explanation for the same. The Union Ministries of Information and Broadcasting and of Law and Justice have expressed the view that the rationale of amending Entry 55, List II was that the revenue from advertisements broadcast/telecast by radio/television should be fully available for the development of these services. Further, a tax on such advertisements might seriously erode accrual of revenue from them. We are not able to agree with these views as a tax on advertisements would have to be additionally borne by the advertisers without cutting into the revenues accruing to the Union. In view of the fast-growing commercialisation and competition, any adverse indirect effect of such a tax on revenue from advertisements on television and radio shall not be serious. For example, a steep hike in rates of advertisements on television effected in February 1987 did not result in reduced demand for advertisement time.

10.9.29 As such, the implications of the amendment under reference amount to taking away the States' power in respect of taxation of advertisements broadcast on radio or television and, in addition, to denying them a share in the net proceeds, should the Union Government levy this tax (presumably under Entry 97 as it does not find a mention elsewhere in List I). This position appears quite anomalous to us. Such a tax, in principle, is on the same footing as the one on advertisements published in newspapers (Entry 92, List I) - only the media differ. It is, therefore, only logical that it should have found a place in Entry 92, List I and also been included in Article 269. As the television/telecasting network gets extended to large parts of this country, the revenue from this source is bound to increase fast. It will then be for the Union Government and Parliament to consider and exercise this power of taxation under this newly added head.

10.9.30 For all these reasons, we recommend that the Constitution should be suitably amended to add the subject of taxation of 'advertisements broadcast on radio or television' to the present Entry 92, List I and Article 269(1)(f).

GRANT IN LIEU OF RAILWAY PASSENGER FARE TAX

10.9.31 The State Governments have expressed serious dissatisfaction with the inadequate grant given in compensation of the repealed Railway Passenger Fare Tax. Such a tax was initiated in 1957 in accordance with the Railway Passenger Fares Act, 1957. It was repealed from 1st April, 1961 in pursuance of a recommendation by the Railway Convention Committee on the ground that the tax had reduced the scope for raising railway passenger fares. The States have since been paid grant in lieu of the tax which was initially fixed at Rs 12.5 crore per annum and raised to Rs 16.25 crore from 1966-67 and again to Rs 23.12 crore for the period 1980-81 to 1983-84. The Eighth Finance Commission has raised the grant to Rs 95 crore per annum. The States have in the past felt dissatisfied about the fixed nature of this grant whereas the yield from railway passenger fares has increased manifold since 1961. Following this, a suggestion has also been made for re-imposition of the tax. The successive Finance Commissions, while generally sympathising with the States' viewpoint did not find re-imposition of the tax advisable. The Eighth Finance Commission, however, found scope for levying the tax but observed that no such tax should be levied so long as the present arrangement of grants to States in lieu of the tax continues.[54]

10.9.32 By raising the lump sum grant in lieu of the Railway Passenger Fare Tax, the Eighth Finance Commission has assuaged the feelings of the State Governments. While the matter, for the present, seems to have been settled amicably, for future we would only suggest periodical review and suitable adjustment of such lump sum grant on the recommendations of the Finance Commission.

10.9.33 We have also noted that the implementation of the above-mentioned recommendation by the Eighth Finance Commission was somewhat delayed. In the Explanatory

54 *Report of the Eighth Finance Commission*, 1984, Para 15.61, Page 117.

Memorandum laid before Parliament the procedure of its consideration by the Railway Convention Committee was mentioned.

10.9.34 The Finance Commission makes recommendations to the President. It would be unfortunate if the recommendations of the Finance Commission are again subjected to detailed scrutiny by yet another body, only because of likely impact on a department of the Union Government. Such matters should be treated as internal matters calling for inter-departmental adjustments in the functioning of the Union Government. We recommend that the Union Government should signify its acceptance of the Finance Commission's recommendation in regard to this item also along with the other items while placing the Explanatory Memorandum before Parliament.

IMPACT OF DEARNESS ALLOWANCE, ETC.

10.9.35 A major complaint of the State Governments is that periodical upward revisions of pay, dearness allowance, terminal benefits, etc., of the Union Government's employees cast considerable burden on their finances as there is pressure on them to raise the benefits to their own employees, covering not only Government servants but also employees of local bodies, teachers, etc. Due to bunching of such expenditure-obligations, the burden on the States' budgets often becomes unbearable, particularly for the less-developed States, thus wiping out the availability of surpluses from current revenues for development. On the other hand, during the last few years, revisions in the rates of salaries and emoluments in many States have been frequent and substantial and in some cases have overtaken the pay-scales and benefits of the Union Government's employees.

10.9.36 The Finance Commissions have shown increasing concern with the States' expenditure requirements in this regard. The Eighth Finance Commission allowed dearness allowance up to an average of 520 points (All India Consumer Price Index Number with base 1960=100). However, the experience in this regard has been that the rate of inflation has been significantly higher than the original estimates on which such provisions were based. The burden and uncertainty in financial development due to dearness allowance, pay revisions, etc., has been faced by both the Union and the State Governments.

10.9.37 We note that the Finance Commissions take into account the expenditure liability of the States with respect to dearness allowance, etc., and make a provision for the same. According to some States, this provision has proved inadequate due to the actual rate of inflation being substantially higher than the projected rate. But if inflation increases outlay, it increases revenue also. The permanent secretariat of the Finance Commission recommended by us should make an annual review of the situation. We recommend that, if in any year the net burden of the State seems unduly heavy, the Planning Commission and the Union Ministry of Finance should jointly evolve appropriate relief measures.

ROYALTY ON MINERALS, CRUDE PETROLEUM, ETC.

10.9.38 Some State Governments have alleged payment of inadequate royalty on minerals, petroleum, etc., extracted from their territories. The rates of royalty on minerals were to be fixed by the Union Government once in four years under Section 9(3) of the Mines and Minerals (Regulation and Development) Act, 1957. Following an amendment of the Act in 1986, this period has been reduced to three years. Similarly, in case of crude oil, the rates of royalty are fixed under the Oil Fields (Regulation and Development) Act, 1948. Section 6(A)(4) of this Act restricts the Union Government to fix the rate of royalty in case of any mineral oil not to exceed 20 per cent of the sale price of that oil at the field or well. The provision for considering the revision of the rates of royalty in the case of crude oil, etc., has been modified on persistent demand by the States to three years recently, *vide* Section 2 of the Oil Fields (Regulation and Development) Amendment Act, 1984.

10.9.39 A major demand of the State Governments has been payment of royalty on an *ad valorem* basis and not on the basis of a specific amount per tonne, specially in view of frequent and sharp increases in the prices of many minerals and crude oil. A State Government has cited the Nehru Award of 1962 and Indira Gandhi Award of 1968 in support of its demand that the royalty on crude petroleum should be based on 'full-posted price' rather than on an artificial selling price of indigenous crude. On the other hand, the State Governments have levied cesses, mineral rights tax and surcharge which are not uniform among the States. This is alleged to have imposed a discriminatory burden on the price of minerals' over and above the rate of royalty.

10.9.40 The question of royalty on mineral products is an area where, besides providing adequate rates to the States, the principles of pricing policy, the real factors behind movement of international price of crude-petroleum, the implications of increase in the price of basic inputs, etc., are to be considered. We have dealt with these issues in our chapter on Mines and Minerals. If there are administrative considerations against making royalties *ad valorem,* there are equity considerations against not revising them for 3 or more years in times of persistent inflation. As recommended therein, the review of the royalty rates on minerals should be made every two years and well in time, as and when they fall due. The same procedure should also apply to royalty on petroleum and natural gas.

SUGGESTIONS FOR NEW INSTITUTIONS

10.9.41 While suggesting solutions to the problems in Union-State financial relations some State Governments, as also others, have suggested creation of new institutions. Such suggestions are made for two categories of institutions: (a) a machinery for consultation and discussion on issues of mutual economic interest between the Union and the States, and (b) institutions, with adequate representation of the States, also for specific purposes such as a Loans or Credit Council and an Expenditure Commission. The suggestions for the new institutions thus emanate from both a positive urge for a larger measure of consultation between the Union and the State Governments on financial and economic issues and from a feeling of arbitrariness in the approach of the Union Government to some matters.

10.9.42 One State Government has observed: 'A large part of the inadequacy in the functioning of Union-State financial relations, as reflected in persistent grievances seemingly harboured by the States and the concern expressed by them before different forums, could have been taken care of by providing effective means of consultation, on a regular basis, between the Centre and the States on all matters pertaining to financial relationship between them'. Another State Government has suggested that consultation between the Union and the States on financial matters could be ensured by a Committee of Finance Ministers of the States presided over by the Union Finance Minister. Some others have suggested that it would be desirable if the views of the State Governments are ascertained before moving a Bill to levy or vary rate-structure or abolish any of the duties enumerated in Articles 268 and 269. Granting of exemptions and lowering of rates of Income Tax, net proceeds of which are now sharable with the States to the tune of 85 per cent, by the Union Government is often cited as another area where the State Governments should be taken into confidence.

10.9.43 The Fourth Finance Commission had observed that there should be provision for inter-Governmental consultation as there was a wide-spread misunderstanding about the Union Government's policy arising from its alleged tendency to neglect shared revenues and inadequate exploitation of taxes under Article 269. The Sixth Finance Commission was also of the view that a significant improvement in the financial relations between the Union and the States would be achieved if decisions affecting revenues of States were taken after the widest possible measure of consultation as underlying the spirit of Article 274 of the Constitution. A State Government has also suggested that Article 274 be amended to include 'States' besides the 'President' for introducing or moving any Bill or amendment in which States are interested.

10.9.44 The Srinagar Conclave of Opposition Parties (October, 1983) had also suggested an institutional forum for consultation between the Union and the State Governments on fiscal issues of mutual concern. However, neither the State Governments nor the Finance Commissions have dwelt on the organisational details of a forum for regular and formal consultations on financial matters.

10.9.45 In the context of planning relationship, one State Government has suggested a National Planning and Development Council. An eminent economist has suggested setting up of a similar Council, with representation from the States, to take care also of their wider interests, for example, in the field of industrial licensing, export and import licensing, subsidies, incentives, employment, etc.

10.9.46 Evolution of healthy Union-State relations in respect of all financial matters is basic to the proper functioning of a two-tier polity. We have noted that in the Constitution the thorny problem of division of resources between the Union and the States and among the States has been removed from the political arena by providing for a Finance Commission. Transfer of resources for Plan purposes also, to a very large extent, is based on accepted formulae and objective criteria. However, apart from the question of devolution of resources, there is a large area having interface between the Union and the States in respect of financial and economic relations. There is imperative need for organic linkage and coordination between the two levels of Government in raising resources and controlling of expenditure.

10.9.47 The major areas or matters requiring coordinated action may be classified broadly into four groups:

(i) actions of the Union Government which could result in higher resources for the States and also prevent loss of revenues to them;
(ii) restrictions resulting from Union action on taxation by the States;
(iii) actions of Union Government causing increase in States' expenditure obligations; and
(iv) fiscal and monetary policies having a bearing on States' finances.

Group I

(a) *Raising Resources from Heads of Taxation covered by Articles 268 and 269:* We have already noted in paragraphs 10.5.13, 10.5.32 and 10.9.26 that the question of raising more revenues from taxes mentioned in these Articles, requires periodic review in consultation with the States.

(b) *Revision on Rates of Royalty:* We have considered this matter in detail in the chapter on Mines and Minerals. We have noted therein the complaint of the States that not only the rates of royalty are low but they are also not revised frequently. The Union Government has pointed out that the States have been imposing large cesses and varying them frequently. This is causing serious problems in ensuring the availability of these basic inputs for economic development at uniform prices throughout the country. Clearly, there is need here for consultation and coordinated action between the Union and the States in this matter.

(c) *Policies and Administration of Additional Duties of Excise on Specified Commodities in lieu of Sales Tax:* States complain that the Union Government has for long followed a policy of adjusting the Basic and Additional Excise Duties in a manner that deprived the States of revenues which they would have realised, had the Sales Tax on these items been continued. Recently, steps have been taken by the Union Government to enhance these Additional Excise Duties.

(d) *Rebates/Concessions in Income Tax, Union Excise Duties, etc; Where the Proceeds are* Sharable With the States: Much of the misunderstanding that exists in these matters could be cleared if only a measure of prior consultation is resorted to.

Group II

Many measures adopted by the Union Government amount to curbs on States' powers of taxation of purchases or sales. We have noted in paragraph 10.9.02 the complaints of the States in this regard arising from control of the Union over taxation of inter-State trade and commerce and taxation of transactions in respect of essential commodities. Levy of Consignment Tax has been made possible by the Forty-sixth Amendment to the Constitution and this tax is expected to yield substantial additional revenues to the States. We have noted that this power has been vested in the Union to ensure that the free flow of inter-State trade, commerce and intercourse throughout the country is not thwarted and the economic unity of the nation is not endangered by the States by erecting discriminatory or oppressive tax-barriers. Taxation of essential commodities has also to be kept low and reasonably uniform throughout the country.

Group III

(a) Actions of the Union in the field of administered prices of steel, coal, oil, etc., have large implications for the States. These increases affect significantly the costs of various projects undertaken by the States. While in the case of irrigation projects the capital costs go up, in power projects the capital as well as operational costs both escalate.

(b) Upgradation of pay, dearness allowance, pensionary benefits and the like of Union Government employees by its inexorable impact, often leaves the States with no choice but to provide similar benefits to their own employees.

Group IV

One of the most important areas requiring coordination of policies is the field of indirect taxation. The Taxation Enquiry Commission, 1953-54, had observed:

'It is in the field of commodity taxation, however, that the need for understanding and coordination is greatest between the Central Government and the States. The sales taxes, as they have evolved in India, do not consist merely of a tax on the generality of sales, but also include special rates on specific commodities, many of which are subject to taxation by the Central Government in the form of excise duties. There are, besides, questions regarding the use of State sales tax system for purposes of economic policy that may have repercussions on areas and interests outside State jurisdiction'.[55]

10.9.48 We have attempted above to illustrate through certain examples the existence of a vast area requiring inter-governmental coordination of economic policies. As observed by the Taxation Enquiry Commission, with growing importance of public finance in the national economy, and with increasing linking of the Union and the States in the fiscal system, it has become important to develop an integrated, national approach to the problems of mobilisation of resources including taxation and expenditure.

10.9.49 We are of the view that consideration of various financial matters, in the setting of a national perspective is essential to remove any misunderstanding with respect to fiscal measures adopted by the Union and the States as also to evolve mutually accepted policies. Keeping in view the importance of financial relations, it is necessary to provide a forum which will adequately respond to these needs. It is essential that various issues are examined by expert groups from time to time before the same can be brought up for consideration at a political level. This will facilitate crystallisation of issues and indicate possible solutions and remedial actions. We have recommended in the chapter on Economic and Social Planning that National Economic and Development Council should be constituted under Article 263 as the apex institution for Inter-Governmental consultations on all economic and social developmental policies.

55 *Report of the Taxation Enquiry Commission*, 1953-54, Vol. I, p. 167.

Therefore, any forum for discussing financial aspects should be integrated fully into this arrangement.

10.9.50 We recommend that a Sub-Committee on Finance of the Standing Committee of the NEDC may be constituted consisting of the Union Finance Secretary and the Finance Secretaries of various States and Union Territories. It will consider all such matters calling for coordination of economic policies, as may be entrusted to it by the NEDC or its Standing Committee. This body will report to the Standing Committee of the NEDC. Since Planning Commission would be providing the secretarial support to the NEDC, the same may be extended for this body also. This will ensure expert consideration of various aspects of the problems and adequate consideration of the views of the Union and the State/ Union Territories. The role of this Sub-Committee will be deliberative and advisory and helpful in forging a consensus on financial matters.

EXPENDITURE COMMISSION

10.9.51 Given the overall resource shortage and growing responsibilities of both the Union and the State Governments, increasing concern has been shown about their pattern of expenditure. Criticism has been levelled against both the tiers of Government with respect to their priorities in spending, coupled with allegations of wastage and fiscal inefficiency. There is also a specific allegation that the Union Government incurs substantial expenditure on State-subjects all of which cannot be justified in terms of its role specified in the Constitution. It has been pointed out by many in response to our Questionnaire that the present agencies concerned with expenditure control, namely, the Comptroller and Auditor General of India and Public Accounts Committees of Legislatures have not been very effective in this regard. For quite some time there has been a suggestion that a National Commission on Expenditure should be created to examine the patterns of expenditure of the Union and the State Governments. The idea of an Expenditure Commission was also endorsed in a Seminar on Centre-State Relations held in Bangalore in 1983. However, none of the State Governments, except one, has favoured the proposal for such a Commission. This particular State Government has suggested a National Expenditure Commission as an *ad hoc* body, to 'go into the expenditure of the Central and State Governments thoroughly and rationalise the basis for assessment of revenue surpluses for the guidance of future Finance Commission'.

10.9.52 Indeed, a Commission on Public Expenditure was set up in India by a Resolution of the Union Government on May 29, 1979, as a result of the stress laid by the then Deputy Prime Minister-cum-Finance Minister on the need for containing the growth in public expenditure, while presenting the budget for 1979-80. Among other things, the Commission was required to look into the areas in which economy could be effected, identify non-essential activities or overlapping functions between the various departments of Government of India and State Governments, review the creation of new posts and suggest measures for containing expenditure on staff. It was also required to review the existing arrangements for planning, execution, monitoring and evaluation of major projects and programmes. The Commission was wound up on January 31, 1980, i.e., after about eight months of its becoming operational, but before it could submit its report to the Government.

10.9.53 Before considering the need for an Expenditure Commission it is necessary to go into the adequacy of the existing machinery for expenditure control. The basic control on budget rests with the legislature. After passing the budget, the legislative control continues with the object of ensuring that the funds appropriated are properly used for the purposes specified and in an efficient manner.

10.9.54 The important instruments of Parliamentary control are the Committees of Parliament, viz., the Public Accounts Committee and the Estimates Committee. The latter is also required to keep an eye on securing economy and efficiency in expenditure and to suggest necessary modifications. The Committee on Public

Undertakings also seeks to ensure prudence in the management of finance by the public undertakings.

10.9.55 In a Parliamentary system, the role and authority of the legislature in determining priorities are supreme and cannot be questioned. However, for ensuring adherence to the priorities evolved, the legislature has to pay utmost attention to the budgetary proposals. Pre-vote scrutiny of the estimates is a very crucial stage. It may not be possible for Parliament or a State Legislature to go into the details of all the estimates. A practical way may be to constitute small Sub-Committees which could consider the estimates. However, it is for Parliament and State Legislatures to evolve suitable procedures in this regard.

10.9.56 A significant feature of the Constitutional provisions is that the Comptroller and Auditor General of India has the authority to audit all expenditure from the revenues of the Centre and the State Governments. He has to ascertain that the amounts shown in the accounts are duly disbursed and the expenditure conforms to the authority which governs it. The reports of the Comptroller and Auditor General are placed in Parliament and the State Legislatures and form the basis for further discussion by the Public Accounts Committee with the concerned departments.

10.9.57 While the system of audit and expenditure control is quite elaborate, some problems in its working have been highlighted. For example, it has been pointed out that there are delays in the preparation and submission of audit reports. The maintenance of accounts in the Treasuries and their reconciliation leaves much to be desired. There has to be a greater emphasis on evaluation audit. We are given to understand that processes are afoot to bring about qualitative improvements in these respects. However, the need for an efficient system of audit and accounts to serve as basis for expenditure control cannot be over-emphasised.

10.9.58 It has to be appreciated that there are processes subsequent to audit which are important for effective expenditure control. Indeed, the Comptroller and Auditor General of India can do little to reshape priorities and norms in spending. We have been informed that in several States, audit reports do not get the importance they deserve. They are often submitted to the Legislatures towards the fag-end of their sessions, leaving little time for a fruitful discussion. Otherwise also, the discussions, it is alleged, are often insufficient and done in a routine manner. It has also been emphasised that the Public Accounts Committee, the Committee on Public Undertakings and the Estimates Committee need pay greater attention to the Audit Reports and it should be ensured that the executive responds to them well in time. Backlog of arrears in the consideration of the Audit Reports has been observed. In the case of a particular State, as in September 1986 the last report on which discussion had been completed related to 1971-72.[56] Such delays, as also non-regularisation of excess expenditure in relation to amounts granted, create a slackening tendency in expenditure-control, which is incompatible with the spirit of the Constitution. The post-audit process, indeed, needs to be further strengthened.

10.9.59 We are of the view that the establishment of an Expenditure Commission as a permanent or an *ad hoc* body for 'one-shot operation' is not necessary. A better alternative is to strengthen the existing system itself. For this purpose, it will have to be ensured that the existing institutions themselves play the role expected of them. This is indeed, an area where further institutional mechanisms and safeguards cannot be expected to substitute the conscience, will and responsibility of those on whom a duty in this regard has been appropriately devolved by the system.

56 Observation made by the Comptroller and Auditor General of India in his address to the Seventh Conference of Chairmen of Public Accounts Committees on September 9, 1986.

10.9.60 The Constitution has done away with the multiplicity of audit authorities and has made the Comptroller and Auditor General of India as the sentinel of the country's finances. The merits of the present system of terms of uniformity and economy in the cost of audit are obvious. There is functionally a close interaction between the Union and the State Governments in fiscal and financial matters. Application of uniform principles and procedures in the maintenance of accounts at the two levels of Government, their supervision by a common and independent constitutional authority, early detection of any irregularities and initiation of timely remedial action are the hall-marks of our audit system. It will, indeed, create complications, both in administration and understanding, if multiplicity of authorities come into being and prescribe their own systems of accounting and procedures. There is also advantage in the present uniform authority in terms of economy in cost and audit services. We are, therefore, unable to support the suggestion that Entry 76 of List I be modified to provide for separate Auditors General at the State level. We are further unable to agree with the view-point of a State Government that the present centralisation of audit is the root-cause of the procedural delays. Scope for reducing delay in the finalisation of accounts has to be considered by the Comptroller and Auditor General himself, who indeed is seized of the problem and has over time brought about improvements.

10.9.61 It is also not possible to support the suggestion made by another State Government, that evaluation audit should be entrusted to an agency constituted by the State Government itself, as a qualitative improvement in the procedures of audit has to be intrinsic to the system. In our view, there is no pressing necessity at present to have separate Federal and State audit services.

OPERATIONAL IRRITANTS

10.9.62 The last thirty-seven years have witnessed progressive enlargement in the scale of fiscal operations and proliferation in the activities of both the Union and the State Governments. This has obviously increased the area of interaction between the two levels of Government. A few State Governments have brought to our notice some 'irritants' in the day-to-day working of the financial arrangements. By their very nature these do not call for constitutional remedies, or far-reaching institutional changes, but merit mention for consideration of procedural improvements. Some of these problems have been noticed in the context of the issues discussed earlier. The other irritants relate to the arrangements and procedures governing release of funds to relieve natural calamities, grants for upgradation of administrative standards and Central assistance for State plans and Centrally Sponsored Schemes.

RELIEF FOR NATURAL CALAMITIES

10.9.63 The system regarding financing of relief expenditure in the present form was standardised by the Seventh Finance Commission and modified with respect to the provision of margin-money by the Eighth Finance Commission. The salient features of the present scheme are:

(i) Margin-moneys towards expenditure on natural calamities have been fixed by the Eighth Finance Commission taking into consideration the average of non-plan expenditure on the relevant items during 1978-83 (aggregate for all States Rs 240.75 crore in contrast to Rs 100.55 crore recommended by the Seventh Finance Commission).

(ii) Half of the margin-money for each State was built into its re-assessed expenditure forecast by the Finance Commission and the remaining half left to be provided by the Union Government.

(iii) On the occurrence of a natural calamity, if the order of expenditure is estimated to be in excess of the margin-money, the concerned State sends a memorandum to the Union Government. After examination of the memorandum in the Union Ministry of Agriculture, a Central Team visits the State for on-the spot assessment of the damage.

(iv) The report of the Central Team is considered by the High Level Committee on Relief, which recommends ceilings for different items. After considering the recommendations of the Committee, the Finance Ministry fixes the ceiling of expenditure and communicates the same to the State Government. The amount in excess of the margin-money qualifies for Central assistance.

(v) The pattern of Central assistance distinguishes between drought as one category and 'floods, cyclones, earthquakes, etc.', as another. In case of drought, the expenditure is to be treated as part of the Plan for which, subject to approval by the Central Team/High Level Committee, advance Central assistance is released up to five per cent of the outlay of that year's annual plan. If the relief expenditure cannot be contained within this limit, the extra amount is provided by the Union Government as 50 per cent loan and 50 per cent grant. In case of floods, cyclones, and other natural calamities of the excess of expenditure over the margin-money, 75 per cent is given as grant against which a matching expenditure of 25 per cent is made by the State Government.

(vi) The unspent amount of margin-money is carried forward to the next year.

10.9.64 The State Governments have highlighted the following problems with respect to the arrangements for financing natural calamities relief:

(i) A few States have suggested that relief on natural calamities should be treated as a national obligation.

(ii) Central assistance towards drought should be put on the same footing as for floods and cyclones and should preferably be given outside the Plan.

(iii) The procedure for deciding Central assistance is time-consuming and does not ensure an objective assessment.

(iv) Because of the delay in receiving Union Government's decision, the State Governments have often to incur expenditure covering the former's portion of margin-money, at the cost of burdening their own finances. Besides, there is uncertainty that the pattern of expenditure might not find approval. States should have freedom to incur expenditure on any item subject to an overall ceiling.

(v) The assistance should continue even beyond the financial year, say up to the month of September.

10.9.65 Successive Finance Commissions have considered the question of providing relief to the States in the event of natural calamities. They have recognised that the State Governments are primarily responsible for organising such relief. The Seventh Finance Commission had observed that with a view to minimising any tendency for wasteful expenditure on the part of the States, they should bear a significant share of total relief expenditure burden. The Union Government is expected to supplement their efforts through the provision of Central assistance. This is as it should be. There is no doubt that natural calamities are to be viewed as a national problem, but this cannot be interpreted to mean that the Union Government should bear the entire expenditure on their account.

10.9.66 The Seventh Finance Commission, for the first time, brought out the distinction between a situation arising out of drought and that due to floods, cyclones, etc. This distinction has been continued by the Eighth Finance Commission also. The Seventh Finance Commission had provided for a more favourable flow of Central assistance for floods, cyclones, etc. *vis-a-vis* a drought situation, on the grounds that the serious damage caused to the assets by the former category of natural calamities 'cannot be properly or adequately taken care of in the present scheme of Central assistance. A clear indication of this is the inclusion in recent years .... of expenditure of non-Plan nature in items taken into account for advance Plan assistance which, by definition should be available only for expenditure which creates new assets'.[57] We are in agreement with the above views.

10.9.67 There cannot be two opinions that in the event of a natural calamity, relief must be given immediately. State Governments should be able to utilise their margin-money as well as the share of the Union Government as intended. We do not see any insuperable difficulty in sending a Central Team to the affected State immediately after the receipt of the State's request supported by adequate details of the damage incurred and the nature and extent of the assistance needed. We note that the Central Teams visit the affected areas and hold detailed discussions with the State Government. We see no better alternative for arriving at an objective assessment keeping in view the urgency of the situation. It is for the State Governments to assess and convince the Central Team in making such assessment of the damages caused by the natural calamity. In a situation of drought, it should be possible for the State Government to prepare a detailed memorandum and for the Union Government to assess the extent and nature of assistance to be given well in time. The drought situation gets built-up over a period of time. In the event of a cyclone or floods, immediate need is for providing relief to the victims by way of clothing and shelter. Emergency repairs to roads for restoring communication, irrigation and drinking water sources, etc., are also to be taken up immediately. If appropriate norms are formulated by the Union Government, in consultation with the States, there should be no difficulty for the State governments in taking up relief operations immediately without waiting for formal approval from the Government of India. The Central Team to assess the damage caused by natural calamities should invariably be headed by the Adviser in charge of that State in the Planning Commission, as was the practice in the past. It would be his responsibility to help the Commission in assessing the States' performance over time in this regard.

10.9.68 We recommend that a procedure which enables States to expeditiously provide necessary succour and relief to the affected people should be evolved in consultation with the States along with suitable norms in regard to the scale of relief. This calls for a time-bound programme. Formulation of standard formats for submission of memoranda by the States will greatly help the Union in dealing with the requests of various States urgently and on a uniform basis.

10.9.69 As regards the suggestion to give the States freedom to incur expenditure on any item within the ceiling, it may be observed that the Central assistance is computed on the basis of requirements of various individual sectors. In our view it is not possible to give the States blanket permission to incur expenditure on any item whatsoever within the ceiling. Nevertheless, it is necessary to recognise that it is the State afflicted by the calamity which is better conversant with the local needs. The State visited by such a *vis majore* must form the focal point itself - rather than placed in a strait-jacket - with better scope for necessary adjustments. In a calamitous situation, the State should have a reasonable discretion to make inter-district or inter-sectoral adjustments. To allay the apprehensions that the expenditure pattern adopted under the stress of urgency may not find approval, we would suggest that norms in regard to items of expenditure which are to be incurred immediately, e.g., relief by way of free issue of foodgrains, clothing and rebuilding of shelters in the event of floods may be evolved by the Union and communicated to all State Governments.

10.9.70 We find considerable merit in the suggestion that relief assistance would extend beyond the financial year. The main working season in most parts of the country is from December to June-July. The rainy season begins in June or July. Thus, if restoration works are to be carried out in the event of floods, or if employment is to be provided in case of drought, the financial year loses its importance. We would suggest that assistance required till the next

57 *Report of the Finance Commission*, 1978, Chapter IV, Para 13, p. 52.

June/July should be decided in the beginning itself so that relief works can be properly planned and executed.

10.9.71 The Union Ministry of Finance has drawn our attention to certain disturbing trends. It has been pointed out that the demands made by State Governments are rising sharply and the ultimate relief found necessary is only a fraction of this demand. Even with this order of relief, the total burden on the Union has been going up steadily year after year and in 1985-86 it was well over Rs 1,200 crore. It is suspected that there is a connection between the very large demands for relief and increasing deficits emerging in the States' budgets. This is most unfortunate. Such a situation needs to be effectively tackled. Persistent irresponsibility in this regard by a State should be taken into account by the Finance and Planning Commissions in recommending future assistance.

10.9.72 We have pointed out in the preceding paragraphs, the need for leaving with the States considerable discretion in the financing of natural calamities relief. While this is necessary, it is equally important that wasteful expenditure is avoided and the intended benefits are really achieved. The present arrangements for monitoring of expenditure appear to be grossly inadequate. It is necessary that the responsibility for proper monitoring rests on agencies concerned with the administration of relief. Repeated demands for large relief assistance in the case of drought clearly underscore the need to evaluate the effectiveness of schemes undertaken in the previous years both under relief and as part of States' development plans. There should be a system of strict penalties for diversion and misapplication of funds. We would like to lay the greatest stress on setting up of an adequate machinery urgently for this purpose.

10.9.73 A few State Governments and some others have suggested that a National Fund should be created out of which relief should be provided to the States whenever natural calamities occur. The details of the size, operation and management of such a Fund have not been spelt out. One of the State Governments has suggested that this should be a State Relief Fund and its funding should be on a statutory basis. The rationale behind this demand for creating a National Fund appears to be that such a Fund will ensure more expeditious flow of assistance to the States in need, unhindered by political considerations, do away with limitations of margin money and cast a smaller burden on the States facing natural calamities. It may be pertinent to point out that the Sixth Finance Commission (1973) was specifically required to go into this question. The Commission weighed the pros and cons of creating a National Fund towards natural calamities relief. It was the advantage in the proposal in terms of a single focal point at the Centre for coordination, promotion of purposeful inter-Ministerial cooperation if the Fund had an administrative arm of its own, development of technical expertise in analysing natural calamities and creating a sense of common concern among the Centre and the States. On the other hand, that Commission took note of complex administrative problems, the danger of the National Fund arrangement degenerating into a creditor-debtor relationship with the States, introduction of an additional complication in the federal financial structure and the difficulty in covering the requirements in case of natural calamities of very large magnitude. The Finance Commission also noted that most of the State Governments were against the creation of a National Fund. It reached the conclusion that creation of a National Fund for meeting natural calamities funded by both Central and State Governments, was 'neither feasible nor desirable'.

10.9.74 It is important to mention that the existing arrangements for natural calamities relief assistance were evolved subsequent to the consideration of a National Fund by the Sixth Finance Commission. If any switch-over to an alternative arrangement is to be made, it must constitute a distinct improvement over the present system and also take into account other relevant matters like recent introduction of crop insurance schemes, inter-Sate differences in capacity to make contribution to the Fund, relative proneness of the region to natural calamities, etc. An advantage of the Fund, however, could be to further insulate provision of relief assistance from political considerations. All these require expert examination along with an assessment of overall expenditure commitments of the States. We note that one of the terms of reference of the Ninth Finance Commission is to examine, along with other aspects of natural calamities relief arrangements, 'the feasibility of establishing a national insurance fund to which the State Governments may contribute a percentage of their revenue receipts'. As the matter has already been referred to this expert statutory body, we refrain from making any recommendation in this regard.

RELEASE OF GRANTS FOR UPGRADATION OF STANDARDS OF ADMINISTRATION

10.9.75 Since the Sixth Finance Commission, special purpose grants are being provided to the States for upgradation of standards of administration in specified spheres. The present arrangements for the release of these grants have been spelt out by the Eighth Finance Commission: These have been accepted by the Government of India, and are under implementation. These are briefly as under:

(i) Initially, the Ministry of Finance would release a grant of 10 per cent on an 'on account' basis to a State, with a request for necessary institutional arrangements, i.e., setting up of State-Level Empowered Committee to determine various aspects of the schemes, including specification of physical norms and costs, and a plan of action.

(ii) On receipt of the information about the constitution of the institutional arrangements and plan of action in the State, the Ministry of Finance would release another 15 per cent of the grant.

(iii) Subsequent releases of grants are determined on the basis of implementation and physical progress achieved.

10.9.76 The Finance Commission has specified the amounts of such instalments of grants to be released for each of the selected sectors. A Central-Level Inter-Ministerial Empowered Committee has been set up to monitor the progress of the projects and utilisation of grants. It was hoped that this institutional set-up would reduce the delays, and difficulties hitherto experienced in the release of such grants.

10.9.77 A few State Governments have brought to our notice that the Central-Level Inter-Ministerial Empowered Committee had been laying down conditions which made it difficult for them to implement the schemes. It has been argued by them that as the implementation of these schemes casts a burden on the States concerned due to cost-escalation or fluctuations in cost-norms, they should be allowed greater flexibility in incurring expenditure, including changes in year-wise phasing.

10.9.78 As the system has recently come into being, such teething troubles cannot be ruled out. The Central and State-Level Empowered Committees were set up with a view to streamlining the various operational problems, including the types mentioned above, by developing proper rapport between them. The Eighth Finance Commission has recommended that the Central-Level Empowered Committee should be authorised to alter physical targets within the amounts specified by the Finance Commission and also to transfer grants from one scheme to another in the same sector. We are confident that with the flexibility provided in the scheme, it should be possible to implement the same without any serious difficulty. No doubt, these arrangements would be reviewed by the subsequent Finance Commissions in the light of the experience gained and necessary procedural changes recommended by them. In view of this, we do not make any recommendation in this regard.

RELEASE OF CENTRAL PLAN ASSISTANCE

10.9.79 Central Assistance for the Plan for all the categories of schemes now constitutes over two-fifths of the total transfers by the Union to the States. The details of the mechanism and the problems in this regard have been dealt with in the chapter on Economic and Social Planning. Over the years, some streamlining of the procedures has taken place with respect to its allocation, pattern and release. So far as the State-plan sector is concerned, ten instalments, each representing 1/12th of the amount of allocation for a State, are released every month from April to January and the balance is released during February-March after ascertaining the progress of Plan expenditure as a whole and on the earmarked sectors. The additional Central assistance towards the externally-aided projects is release on a quarterly basis, in the months of June, September, December and March. Advance Plan assistance towards natural calamities is released on the basis of the recommendations of the Central Study Team and the High Level Committee on Relief in suitable instalments keeping in view the progress of expenditure.

10.9.80 For the schemes in Central Sector Plan being implemented in the States, the Ministries concerned sanction and release the amounts along with monitoring of the schemes. So far as the Centrally Sponsored Schemes are concerned, since 1977, the Union Ministries have themselves been releasing the amounts. Although no set schedule is followed they have been advised to maintain regularity in the releases.

10.9.81 Some operational problems highlighted by the State Governments in regard to release of Central assistance for the Plan are:

(i) The delay in the auditing of the figures for which the States are dependent on the Comptroller and Auditor General of India, in turn, causes delay in the settlement of assistance.

(ii) In case of Centrally Sponsored Schemes, the conditions imposed by the Union Ministries compel the State Governments to make special efforts to get the Central assistance released.

(iii) Often the Central component of financial allocations for the Centrally Sponsored Schemes are communicated late in the financial year. As the States continue incurring expenditure on the basis of previous year's amount, serious pressure on finances is felt by them.

10.9.82 The above-mentioned problems are procedural in nature. We are given to understand by the Union Ministry of Finance that over the years there has been an improvement in the release of Central assistance to States. So far as the Centrally Sponsored Schemes are concerned, as has been pointed out by us in the chapter on Economic and Social Planning, their modalities should be discussed along with the Annual Plans of the States and monthly releases of Central assistance on their account made on that basis.

(Section 10 not inserted),

REVIEW ARTICLE*

PATTERNS OF AFFIRMATIVE ACTION: THE AMERICAN, MALAYSIAN AND INDIAN EXPERIENCES

S. P. Sathe

Introductory

Equality is one of the cherished aims of any society that wants to be just. Equality is, however, not understood by every one in the same sense. There are different meanings of equality and different ways of achieving it. In societies that are pluralistic, equality also means absence of discrimination on grounds such as ethnicity, religion, language or gender. A formal concept of equality means equal treatment to all and equal protection of law without any regard to inequalities that exist in life and which stem from unequal power relations. Another concept of equality, known as substantive equality, asserts that equality does not mean merely equal treatment of all but also means that only the equals should be treated equally and the unequals should be treated differently. The second view of equality is usually prevalent in democratic societies. The doctrine of reasonable classification is developed by courts for this purpose. It allows the legislature to classify people or things for different treatment if (1) those who are grouped for such different treatment are identifiable as distinct from those who are not included in such a group, and (2) the basis of such grouping is rationally related to the object of different treatment [*Chiranjit Lal* v. *India,* 1951]. For example, the Income Tax Act provides different rates of income tax to people depending upon their income. Persons with higher income are required to pay tax at a higher rate. Here persons earning higher income constitute a group which is distinguishable from those earning less income and income which is the basis of such classification is rationally related to the object of the Income Tax Act of levying tax according to the capacity of a person to pay. This is an example of affirmative action to undo inequality. Fiscal policy is often directed towards reducing disparities of wealth and income.

Such a classification, however, cannot be made on grounds such as religion, race, caste, sex or place of birth. Classification can be made on secular considerations such as physical disability or poverty but not because some one is a Muslim or a Hindu. Normally, ascriptive status is not allowed to be used as a basis of classification. Our Constitution prohibits the use of any of such criteria for providing differential treatment. Article 14 of the Constitution says that the State shall not deny to any person equality before the law or the equal protection of the laws within the territory of India. Article 15 (1) says: 'the State shall not discriminate against any person on grounds only of religion, race, caste, sex, place of birth or any of them'. This provision clearly bars any different treatment to a person on the ground of her religion or caste, or sex or place of birth.

In societies, which contain unequal segments and where such inequality is the result of past unjust policies, affirmative action which gives additional opportunities for the disadvantaged sections to catch up with the forward section is required to be taken. Such affirmative actions are protective as well as compensatory. The words 'protective discrimination' or 'compensatory discrimination' or 'reverse discrimination' have been used interchangeably. Reverse discrimination is in vogue in the United States in respect of the Blacks and in India in respect of the backward classes of people and the tribals. Affirmative action is recommended even by Article 1 (4) of the International Convention on the Elimination of All Forms of Racial Discrimination, 1969, which reads as follows:

> Special measures for the sole purpose of securing adequate advancement of certain racial and ethnic groups or individuals requiring such protection as may be necessary in order to ensure such groups or individuals equal enjoyment or exercise of human rights or fundamental freedoms shall not be deemed racial

Dr. S.P. Sathe is Hon. Director, the Institute of Advanced Legal Studies, Pune.

* *Discrimination with Reason? The Policy of Reservations in the United States, India and Malaysia,* by Nesiah Devanesan, Oxford University Press, New Delhi, 1997, Pp. xi+344, Price 495.

discrimination, provided, however, that such measures do not, as a consequence, lead to the maintenance of separate rights for different racial groups and that they shall not be continued after the objective for which they were taken had been achieved (p. 5).

Beneficiaries of Affirmative Action

The book under review surveys the affirmative action in the United States, India and Malaysia. Really speaking, the affirmative action in Malaysia is not of the same category as those in the United States and India.

In Malaysia, protective discrimination is in favour of the majority, whereas in the United States as well as India, the protective discrimination is in favour of those sections which are considered to be victims of the past social policies and inequitable social structures. The beneficiaries of such reverse discrimination are numerically minorities but cannot be called minorities in the sense in which that term is generally understood. The term 'minorities' is generally used to refer to ethnic or religious or linguistic minorities. Protective discrimination in favour of the Blacks in the United States or the backward classes and particularly the Scheduled Castes and Scheduled Tribes in India is because of their social backwardness and not because they are minorities. It is difficult to call the Scheduled Castes a minority because they are part of the majority community (the Hindus). One of the requirements of their entitlement to reverse discrimination prescribed by the Constitution (Scheduled Castes) Order, 1950 is that they must be professing the Hindu religion. This requirement was upheld by the Supreme Court in *Soosai* v. *India,* 1986. This writer has expressed a contrary view [Sathe, 1986, p. 359]. The Scheduled Castes are those people who have been the victims of the Hindu caste system. It is not necessary that they should be professing the Hindu religion in order to be entitled to reverse discrimination. Even if they are converts to Christianity or Buddhism, they should be entitled to reverse discrimination if they were born or if either of their parents was born in any of the castes mentioned as the Scheduled Castes.

The fact remains that the Scheduled Castes (SCs) do not constitute a minority in the sense in which that word is understood in Article 30 of the Constitution. The Scheduled Tribes (STs) are also not characterised as a minority because they are either Hindus (though the Hindu family law does not apply to them) or Christians or of any other religion to which they might have been converted. This has to be stated explicitly because other minorities such as ethnic, religious or linguistic minorities are not given the kind of preferential treatment that is given to the Scheduled Castes, Scheduled Tribes and Backward Classes. In Malaysia, what is done is to protect the local majority against the immigrant minorities such as the Chinese and the Indians. Social and economic backwardness is a common factor that necessitates affirmative actions in all the three countries, though causes of such backwardness are different in three countries. In the United States, the social backwardness is the result of the racist policies of the dominant White majority, in India it has resulted from the traditional caste system and, in Malaysia, it is the result of colonialism.

Gender and Affirmative Action

Gender is another ground for discrimination. Women have been subjected to subordination in all patriarchal societies. In all the three countries that are compared, gender discrimination has existed almost to the same extent. In the United States, until 1873, women were not allowed to practise law and such a ban was upheld by the United States Supreme Court [Justice Bradlay in *Bradwell* v. *Illinois,* 1873]. Affirmative action to undo discrimination against women is a recent phenomenon and is qualitatively different from the affirmative actions that are needed for the disadvantaged people, such as the Blacks or the Scheduled Castes and Scheduled Tribes. Gender inequality is reinforced by various social and cultural factors. Women are spread over all the classes, they are part of the bourgeois as well as the proletariat classes. Even women who are part of the bourgeois are the underdogs as compared to the men folk of their class. A Black woman or a dalit woman is as much exploited by Black men or dalit men, respectively, as a white woman by White men or a Brahmin woman by Brahmin men. Gender related protective discrimination, therefore, needs to be treated separately. It is much deeper than racial or caste discrimination. In gender justice, the very framework of relationship between man and woman is questioned. The questioning of the framework is also necessary while dealing with the socially and educationally disadvantaged sections like the Blacks or the Native Indians in the United States or the Scheduled Castes and Scheduled Tribes or Backward classes in India. In the case of the minorities, no such questioning of the framework is necessarily called for. What is required is the corrective justice within a framework by assuring equal protection, freedom of religion and guarantees of separate identities as cultural or ethnic group. By minority, I mean an ethnic or religious or linguistic group which is numerically small as compared to the majority. The target group for affirmative action is identified by its powerlessness and not because of its numerical minority. A majority also may be powerless, e.g., other backward classes or women or the Blacks in South Africa before the end of apartheid. It is the treating together of all such affirmative actions in respect of these diverse target groups that has made the work under review rather superficial. The canvass being wide, the subtleties and sophistications of each of such discriminations and the ameliorative strategies adopted to combat them have been blurred and diffused.

Minorities Distinguished From Victims of Social Injustice

We would like to point out that the question of ethnic, religious or racial minorities is not similar to the question of the powerless people who need special opportunities. The ethnic, religious or linguistic minorities are entitled to two types of rights : (a) the right to equal protection of law and (b) the right to preserve their distinct identity as a group having its own culture, traditions and language. Majoritarian nationalism often insists on only the first and describes the second as appeasement. Considering the fact that every nation in modern times tends to be pluralistic and therefore contains sub-national groups conscious of their distinctness, an integrationist approach, which contemplates both of the above guarantees to the minorities, tends to provide for greater peace and stability. The Constitution of India provides for both of the above guarantees to the minorities. It guarantees them equality before the law and equal protection of law (Article 14, Constitution) and prohibits discrimination on the ground of religion, race, caste, sex, etc. (Articles 15, 16 and 29(2), Constitution), also grants them the right to freedom of religion, (Article 25, Constitution) the right not to be imparted any religious instruction without their consent, (Article 28, Constitution) the right to preserve their distinct language, script or culture (Article 29 (1), Constitution), and the right to establish and administer educational institutions of their choice (Article 30(1), Constitution). The minorities are not entitled to any reverse discrimination, which is provided for the Scheduled Castes, Scheduled Tribes and other Backward classes. To this list of beneficiaries of reverse discrimination, women are now being added recently.[1]

The problem of unequal growth of various sections of society due to historical reasons is much more complex and needs a variety of legal and political strategies for bringing about equality than the problem of accommodating various ethnic minorities. Minority rights are now universally recognised and they form part of the international human rights charter. According to the author, 'Malaysia, though not free of ethnic prejudice and discrimination, was never socially stratified in the manner that American or Indian society has been' (p. 94). In Malaysia, what is being done is the assertion of the majority's right against the Chinese and Indian minorities. It is somewhat similar to what the Indian Constitution provides in clause (3) of Article 16 which reads as follows:

> Nothing in this article shall prevent Parliament from making any law prescribing, in regard to a class or classes of employment or appointment to an office under the Government of, or any local or other authority within, a State or Union territory, any requirement as to residence within that State or Union territory, prior to such employment or appointment.

Article 16 (1) guarantees the fundamental right to equality of opportunity for all citizens in matters relating to employment or appointment to any office under the State. Since the residents of a state may require protection against persons coming from outside the state in respect of getting employment, Clause (3) of Article 16 has been made. It protects local people, who are often in majority, from competition with those coming from outside. The Malaysian legal provisions go further than the above mentioned Indian constitutional provision in so far as they discriminate not on the ground of residence but on the ground of ethnicity. They use the technique of reservations in favour of the local Malaysians not only because they are backward but because they are ethnic Malaysians as opposed to the Chinese and Indian Malaysians.

Auditing the Affirmative Action

The author asks: under what circumstances, if any, are racial classifications and preferences permissible in remedial action? Are preferential policies applicable exclusively to historically oppressed groups or also to other groups currently handicapped? Are such measures necessarily of short term duration or can they be the basis of medium and long term programmes? The author also examines the following questions with reference to the experiences in the United States, India and Malaysia: (1) How effective are laws which prohibit discrimination in eliminating discrimination, reducing prejudice and promoting mobility? Do they work or merely drive discrimination underground, i.e., make it less open? (2) If prejudice is overcome (or is absent), under what circumstances, if any, are discrimination and barriers to mobility likely to exist? (3) What kinds of group-based preferences and what circumstances (if any) are least likely to reinforce group identities and can help to promote mobility and reduce prejudice? What kinds of preferences are most likely to reinforce group identities and prejudice? (4) What is meant by efficiency and merit? Can ethnicity, gender and other preferences be compatible with the notions of merit and efficiency? (4) Do preferences always yield net benefits to the favoured group? Or, is it a mixed blessing of doubtful value? Are there effective alternatives to group based preferences? If so, what are they and what has their track record been? Do preferential policies constitute an easy and (apparently) cheap short-run solution to social problems? Do these, in fact, prove to be economically inefficient, even in the short-run, and avoid any long-term solution to the social problems? And (5) can preferential policies, once instituted, be withdrawn or phased out without triggering a political crisis?

The author asks when is group preferential affirmative action justified? Differences are bound to exist among individuals which rise from the differential in intellectual capacity, physical capacity, genetic reasons and so on and so forth. What is usually done is to provide equal opportunities and the best ones will doubtless go further than the inferior ones. In a liberal society, such disparities arising out of performance and ability are not grudged. They are considered essential for social progress. This, however, presupposes that the competitors are on the same level. If a person works hard and succeeds more than the other who does not work so hard, her success is considered to be socially desirable and no intervention is called for. However, if a person cannot compete because of the factors beyond her control, intervention may be needed. For example, if a person cannot compete because of poverty, the State may give financial assistance to such a person to overcome poverty. But such financial assistance is not given because of her religion or caste or any other ascriptive factor but because of her poverty. Poverty is a non-ascriptive, secular criterion for entitlement to such preferential treatment. Any one who is poor and who is merited can aspire for such assistance. But can any one claim to get a job because she is poor? Obviously not, because while society benefits by giving scholarship to a poor but merited student, it does not benefit by giving a job to a poor but inefficient person. The former is an input for providing equal opportunities, the latter is a sacrifice of public interest for helping a poor person. Poverty can therefore be a ground for preferential policy in respect of scholarship for education but not for recruitment to a job. But if there are two candidates who are equal in merit, could a person coming from poverty background not be preferred? Similarly, if two candidates are equal in merit, could one, who is physically handicapped not be preferred? Such preferential policies also subserve the cause of equality. But again, this is preference and not reservation, *since both are equally meritorious.*

Types of Preferential Policies

Preferential policies are of various nature. Where distribution of largess is concerned, preference may be given to persons of certain preferred categories such as physically handicapped persons or persons who have suffered from an earthquake or famine or so on. All such policies are governed by secular considerations. Preference is given to individuals because of certain precipitating factors which they satisfy. The poor may be preferred for allotment of housing in a public housing scheme or a licence for a fair price shop or availability of certain goods at cheaper prices. All these are affirmative actions to mitigate the evils of poverty. Preferential strategies may be embodied in fiscal policies as well as in economic policies. These are affirmative actions which a modern welfare state has to take in order to provide for welfare of the comparatively weaker sections of society.

Affirmative actions in respect of the Blacks and the SCs/STs and Backward classes are of a different nature. These actions are based on discrimination in favour of the groups which are identified by their race or caste. In the United States, it is in the nature of preference, in India, it is in the nature of reservations. Such discrimination in favour of a group of persons on the basis of religion or caste or race is *per se* against the principle of democracy and equality. Such discrimination is, however, justified when it is undertaken with a view to undoing inequality which is the result of the past racist or casteist policies. Groups which have remained far behind others because of lack of access to education or other resources cannot compete with the advanced sections and, therefore, the gap between them will almost be permanent, unless some steps are taken to mitigate it. Therefore, greater opportunities will have to be given to such victims of social injustice to help them catch up with the advanced sections. Such victim groups have to be identified by their race and caste, as the case may be, which has been the basis of the past discrimination against them. Therefore, protective discrimination is often based on such forbidden criteria as race or caste, where race and caste are not grounds for discrimination but are identifying criteria for such discrimination. True, the Constitution of India tries to secularise those criteria by using expressions such as 'the weaker sections of society' or 'socially and educationally backward classes of people' but for the purpose of greater specificity also uses the words 'Scheduled Castes and Scheduled Tribes'.

Reservation means that a candidate from a category so earmarked is preferred for appointment, even if she is less meritorious than the other candidate who does not belong to such a group. Only those who belong to those categories, which are identified by their social, economic and educational backwardness, are entitled to such reservation. Mere poverty does not entitle a person to secure a job by reservation. Therefore, the Supreme Court did not allow the Union Government to provide 10 per cent reservation for economically backward classes [*Indra Sawhney* v. *India,* 1992]. Reservations were not contemplated as a method for combating poverty. They were conceived as a strategy for combating backwardness, which includes poverty, which has arisen from caste injustice. The caste system in India has had the most debilitating effect on people and it will take generations for those people to overcome those effects. Poverty and backwardness overlap in most of the cases. Those who are backward are most often poor but all poor are not backward. SCs and STs in India and the Blacks in the United States are invariably poor. But there are poor higher caste people in India as there are poor Whites in the United States.

Affirmative actions in the United States and India differ in respect of reservations. The United States Supreme Court has shown greater allergy to reservation$ of jobs or seats in educational institutions. It, however, allows preferences wherever the White and the Black candidates are equally positioned. It allows greater weightage to women candidates in order to facilitate their recruitment to services or admission to educational institutions.

The American Experience and the Indian Parallels.

The American history of providing equality to the Blacks has been long and arduous. The author tells us how Jefferson's reference to slavery in the Declaration of Independence was omitted in the ultimate draft,It reflected the racist elements that lurked in the minds of the Founding Fathers of the American Constitution. They survived for long even in the judgments of the Supreme Court of the United States. The Supreme Court's decision in 1896 in *Plessey* v. *Ferguson,* in which the doctrine of equal but separate was upheld, manifested such racism. The American law provided that the Blacks could not travel by train in compartments which were reserved for the Whites. There were different compartments for the Whites and the Blacks. This law was challenged in the Supreme Court on the ground that it violated the equal protection clause of the Fourteenth Amendment of the United States Constitution. The Supreme Court held that separate treatment was not *per se* violative of equality. If the separate treatment was an equal treatment, the equal protection clause was substantially complied with. This doctrine is known as the doctrine of equal but separate. This pernicious doctrine was ultimately buried as late as in 1954 in *Brown* v. *Board of Education,* in which the Supreme Court under the leadership of Chief Justice Earl Warren mandated the states to integrate all schools and abolish segregation of White and Black children. The Court clearly said that separate treatment was inherently discriminatory and resulted in denial of equal protection of law.

It is interesting that for some time there was a conflict between the movement for racial equality and the movement for gender equality. In order to avoid division among men, the supporters of racial equality were willing to play down the gender issues. This had infuriated some feminists who retaliated by underplaying the movement for racial equality. However, later the feminists realised that racial equality and gender equality could not be pitted against each other and, therefore, supported the movement for racial equality. In India, fortunately, the feminists did not experience such a dilemma. Women's movement in India is comparatively of a recent origin than the dalit movement, though the movement for social equality had an element of feminist thought right from the beginning. Jotirao Phule, the first Maharashtrian rebel against Brahminism was also a crusader for man-woman equality. Fortunately, the women's movement in India kept its links with not only the dalit movement but also with the movement against fundamentalism and communalism [Kapur and Cossman, 1996]. An attempt is now being made to draw a wedge between the backward classes and women by raising objection to reservation of seats for women in the Lower House of Parliament and the state legislative assemblies on the ground that such reservations would benefit only the daughters and daughters-in-law of the higher castes/classes (*Bahu Beti* brigade). This could be overcome by providing that women of the Scheduled Castes and Scheduled Tribes would share one third of the seats reserved for those groups and their number would be included in the overall 33 per cent seats reserved for women. Such provisions exist in respect of the panchayats and municipalities (Article 243D, clauses (2) and (3) and Article 243T, clauses (2) and (3), Constitution). There is no reservation of seats for the Backward classes in the legislatures, so the question of reservation for women of that class should not really arise. Women of the Backward classes (those other than the Scheduled Castes and

Scheduled Tribes) would naturally be included in large number in the overall quota for women of 33 per cent seats, since electoral considerations would weigh in their favour due to their numbers.

Fighting Against Caste Tyranny: Pre-Independence Era

The author's account of the Indian history of caste discrimination tends to be rather sketchy and full of generalisations. His comments on Gandhi and Ambedkar are too sweeping. Both Gandhi and Ambedkar have grown with the times and it is unfair to hold them by what they said at a particular time during the early years of their encounters with their problems. True, Ambedkar 'wished to ensure that, before the British left, dalits would gain a fair measure of social advancement, adequate legislative safeguards against discrimination, a degree of political organization and empowerment, and recognition as an independent ethnic group' (p. 45). But some expressions are less than fair to them. For example about Ambedkar, the author says:

> A brilliant lawyer and shrewd politician, Ambedkar had a strong hand and played it well. He gave qualified co-operation to the Congress in the period immediately before and after independence. In turn, the Congress recognised the need for reservations (quotas) for Dalits and tribals in the Constitution of free India. Gandhi (a 'twice-born' Vaisya) was uniquely equipped to deliver the support of the Congress (including its ultra-conservative Hindu elements) in this bargain (p. 45).

This paragraph gives a very distorted vision of both Ambedkar and Gandhi, showing them as machiaveillian politicians. Gandhi being a Vaisya or a 'twice-born' has absolutely no relevance here. Ambedkar's dalitness is relevant because he was securing certain rights for that victim community and he belonged to it. But both Gandhi and Ambedkar could transcend the narrow bounds of their communal interests and consider that question from the point of view of national interest. For Gandhi, separate electorates for the Scheduled Castes were divisive of the Hindu society and ultimately of the Indian nation. For Ambedkar, separate electorates would have ensured greater political leverage to the depressed people. It is surprising that the author does not refer to the analysis of Ambedkar's contribution made by M. S. Gore in his book on Ambedkar [Gore, 1993]. Further, the following observation is again unfair to Gandhi as well as to Ambedkar and is historically wrong. The author says: 'In a typical Gandhian move, Ambedkar was appointed Chairman of the drafting committee for India's Constitution, and Minister of Law in the first post-independence cabinet' [p. 45].

Ambedkar had come to the Constituent Assembly after being elected from a constituency, which was in Bengal. During the short term as a member, which abruptly came to an end when the constituency from which he had been elected ceased to be part of India due to partition, Ambedkar had contributed significantly to the debates of the Constituent Assembly. When his membership of the Assembly came to an end, the Congress party on its own thought it fit to retain his services for Constitution-making by getting him elected to the Assembly from the Bombay State (present Maharashtra). There was no bargain involved in this, though according to Granville Austin, the Congress Party purposely surrendered some of its seats in order to bring in members of diverse viewpoints and also the minorities which had not been represented such as Christians, Parsis, Scheduled Castes, Scheduled Tribes and women to the Assembly, in order to make it truly representative [1966, p. 13, footnote 44]. What was the typical Gandhian way in such induction of Ambedkar?

Protective Discrimination: Constitutional Mandate

The Indian Constitution specifically provides for reverse discrimination in favour of the Scheduled Castes, Scheduled Tribes and other socially and educationally backward classes of people. The original Constitution, enjoined upon the State to 'promote with special care the educational and economic interests of the weaker sections of the people, and, in particular, of the Scheduled Castes and the Scheduled Tribes,' and further mandates it to 'protect them from social injustice and all forms of exploitation' (Article 46, Constitution). The Constitution, while providing for equality of opportunity for all citizens in matters relating to employment or appointment to any office under the State (Article 16(1), Constitution), empowers the State to make 'any provision for the reservation of appointments or posts in favour of any backward class of citizens which, in the opinion of the State, is not adequately represented in the services under the State' (Article 16(4), Constitution). Such provision for reservation was constrained by another provision which says 'The claims of the members of the Scheduled Castes and the Scheduled Tribes shall be taken into consideration, consistently with the maintenance of efficiency of administration, in the making of appointments to services and posts in connection with the affairs of the Union or of a State' (Article 335, Constitution).

The original Constitution did not contain clause (4) of Article 15 which permits the State to make any special provision for the advancement of any socially and educationally backward classes of citizens or for the Scheduled Castes and the Scheduled Tribes. This provision was added by the Constitution (First Amendment) Act, 1951. Under Clause (4) of Article 15, the State has been given greater freedom to organise its affirmative action programme. It can be in the form of reservations in educational institutions, preferential treatment in the distribution of largess including scholarships and loans for self-employment, etc. Since Clause (1) of that article says that the State shall not discriminate against any citizen on grounds only of religion, race, caste, sex, place of birth or any of them, Clause (4) of that article allows such discrimination on the forbidden grounds, if it subserves the objective of bringing about the advancement of the socially and educationally backward classes of people and of the Scheduled Castes and the Scheduled Tribes. If discrimination is in favour of 'any socially and educationally backward classes of citizens or for the Scheduled Castes and the Scheduled Tribes', it cannot be faulted on the ground that it is based on religion or caste. Since the Constitution does not mention any limits to the extent of such discrimination, the Supreme Court did it by laying down a rule that reservation should not exceed 50 per cent of the total number of seats in an educational institution or jobs in public service [*Balaji* v. *Mysore*, 1963].

The phraseology used by the Constitution is not uniform because each expression seems to have been used with a specific purpose. Clause (4) of Article 15 uses the words 'socially and educationally backward classes of people'. Clause (4) of Article 16, which provides for reservation of government jobs uses the expression 'backward classes'. For a long time the Supreme Court held that the expression 'backward classes' in Clause (4) of Article 16 had the same meaning as the words 'socially and educationally backward classes of citizens' in Clause (4) of Article 15. However, recently the Supreme Court held that the words 'backward classes' had a narrower meaning than the words 'socially and educationally backward classes' [*Indra Sawhney* v. *India*, 1992]. These provisions must be distinguished from the provisions which provide for reservation of seats for the Scheduled Castes and the Scheduled Tribes in the House of the People and the legislative assemblies of the states (Articles 330 and 332, Constitution). There is a time limit of 10 years for such reservation and that time limit was extended by constitutional amendments by 10 years every time. The present time limit is 50 years. But it is bound to be extended by constitutional amendment. There is no time limit for reservation of jobs or seats in educational institutions. The provision for reservation of seats in legislatures was in continuation of the earlier consensus reached between Gandhi and Ambedkar in the Poona Pact in 1931.

The restrictions which the courts have imposed on reservations under Articles 15 (4) and 16 (4) are not applicable to the reservation of seats in legislatures. These two types of affirmative actions need to be clearly distinguished. Reservations or affirmative actions under Articles 15(4) and 16(4) are benefits derived by individuals because of their belonging to certain disadvantaged groups. Here, whether an individual is really disadvantaged is an irrelevant factor. Her entitlement to reservation is because of her membership of a caste or a tribe. In view of the fact that the Supreme Court has now held that creamy layers from among the reserved category may be excluded, whether an individual is really most disadvantaged, has become relevant. Reservation of seats in legislatures also benefits the individuals who contest elections but the purpose is not to give them the benefit as much as to improve the representation of that caste group in the legislature. In respect of reservation of jobs, the individual is the main beneficiary and the community is benefited incidentally whereas, in the case of reservation of seats in legislatures, the community is the beneficiary and the individuals get benefit incidentally. Both reservations are, however, intended to empower the disadvantaged communities.

The Judicial Activism and Discourse on Protective Discrimination

Referring to the decisions of the Indian courts, the author says: 'With a few notable exceptions, Indian judges have been less activist than American judges and more cautious in tapping the "secret roots" for the "juices of life" referred to by Holmes' (p. 62). The author cites a paragraph from Marc Galanter's book [1984] to support the above view. The view expressed by Galanter in 1984 needs to be reexamined in 1997. On the whole, the judges of the Indian Supreme Court, have been quite activist (liberal) so far as protective discrimination is concerned. The only exception is of the decision in *State of Madras* v. *Champakam Dorairajan* [1951] in which the Court had held an order of the Government of Madras (now Tamil Nadu) reserving seats community-wise as constitutionally void. In fact, that decision was rather misunderstood because of an observation regarding the relationship between the fundamental rights and the directive principles of state policy. The Court said that when there was a conflict between the two, the fundamental rights had to prevail. The Communal Order of the Government of Madras did not reserve seats only for the Scheduled Castes or the Scheduled Tribes but distributed all the seats in a medical college among various castes and communities. This certainly violated the right to equality guaranteed by Article 15 (1) of the Constitution. Barring such a solitary instance in which, though mistakenly, the Court was criticised for being reactionary, there is no other instance of judicial indifference to the cause of protective discrimination.

There are obviously some limitations of the judicial process. One is that it is easier for the haves than for the have-nots to invoke it because of lack of resources as well as of know-how. It is the haves who have more often gone to courts to stall the programme of protective discrimination. Further, the courts' have intervened more often where the OBCs were involved than where the SCs and STs were involved. The category of the OBCs, being more nebulous, was capable of manipulation by the politicians and, therefore, the determination of backwardness as well as the limits of protective discrimination had to be judicially monitored [Galanter, 1997].

The Supreme Court's activism was invoked to constrain the power of protective discrimination given to the State so as to make it consistent with the right to equality before the law or the equal protection of the law. Although majority of the judges are drawn from the higher castes and classes [Gadbois, 1968-69, Pp. 317-36], they do not seem to have shown any bias against the SCs/STs or the BCs. In *Indra Sawhney* v. *India* [1992], the Supreme Court upheld reservation in favour of the other backward classes but imposed some curbs on the reservation power of the State. These two curbs were: (1) that total reservation should not exceed 50 per cent; and (2) that there shall be no reservation in promotion. After this decision, Parliament amended the Constitution and legitimised reservation for the Scheduled Castes and Scheduled Tribes in promotion (The Constitution (Seventy-Seventh Amendment) Act, 1995), and also reservations exceeding 50 per cent in Tamil Nadu (The Constitution (Seventy-Sixth Amendment) Act, 1994). The Court's decisions thereafter show that it has not taken objection to those amendments. On the contrary, the Court has in most of the cases taken favourable view of the claims of the backward classes [See, particularly, *Commissioner of Commercial Tax, Hyderabad* v. *G. Sethumadhava,* 1996].

The basic difference between the Constitutions of the Untied States and India is that the former was based on the philosophy of individualism and minimum State whereas the latter is a product of the twentieth century philosophy of an interventionist State. The Constitution of the Untied States guaranteed equal protection of law while glossing over the existing inequality in social, political and economic life. Affirmative action is implicit in the Indian Constitution and even reservations have been expressly provided for. The American Constitution does not expressly provide for an affirmative action and it had to be legitimised through judicial interpretation. Therefore, we constantly see ups and down in American programme of affirmative action. It has gone only upto preferential policies but has not accepted reservations. Affirmative action has been legitimised by the United States Supreme Court as an important component of the right to equal protection of law guaranteed by the Fourteenth Amendment.

Other two important differences between the American and Indian constitutional scenarios on protective discrimination are (1) that in the United States there is a division among the Republicans and the Democrats regarding affirmative action in favour of the disadvantaged sections whereas in India all political parties have unanimously supported protective discrimination. The latest constitutional amendments which removed the constraints imposed by the Supreme Court through *Indra Sawhney* [1992] decision were passed almost by unanimous voting. The lone dissenter was a Member of Parliament (M.P.) from Shiv Sena. Therefore, the policy of protective discrimination in India does not have such swings as there are in the United States. The author tells us how that policy has suffered during the tenure of President Reagan and how President Clinton is finding it difficult to restore it during his term. (2) The second difference is that unlike in the United States, the appointment of the judges of the Supreme Court is not so politicised. Since Nixon's times the Supreme Court of the United States has been transformed from a liberal court into a conservative court through appointment of judges. Judicial appointments in India are comparatively more professional and the judges have generally projected themselves as apolitical professionals. Yet, the Supreme Court of India has been consistently expanding the rights of the underprivileged sections such as the dalits and women [Galanter, 1997; Sathe, 1993].

Excessive Emphasis on Reservations

In India, unfortunately, there has been too much focus on reservations. Reservations can be meaningful only if other supporting policies are pursued. Since primary education has not been made free and compulsory, as the directive principle of state policy under Article 45 required, many SC and ST boys and girls do not come up to the stage of higher education. Reservation of seats in professional colleges, therefore, benefits only a few. Similarly, very few can reach up to the level of competing for higher jobs. The result is that either standards have to be relaxed to meet the need to fill in the reserved vacancies or the posts remain vacant. A slipshod way of implementing the policy of reservation evokes anger of the elite community against the beneficiaries of reservation. Unless education and primary health are provided to all the poor, even the Scheduled Castes and Scheduled Tribes are not likely to reap the benefits of reservation. Reservations have unfortunately become more a matter of political expediency than social justice. It is easier to satisfy the lobby of the dalits by providing for reservations than by really combating poverty and ignorance that prevail among them. Reservations are, after all, helping only the more advanced among the dalits or the tribals. They do not reach a large number of people who continue to suffer from poverty and exploitation. Land reforms and improving the purchasing capacity of the ordinary dalit by satisfying her basic needs such as shelter, work and education ought to have been given a higher priority in the ameliorative programme. The political elite has found reservation as the safest way of silencing the critics of its inaction on economic and social fronts and of appeasing the leaders of the dalits who are eager to show results in terms of sops even if long term interests of the dalits have to be sacrificed.

The Malaysian Experience

Malaysia provides an entirely different scenario. The past colonial regime had sustained itself on exploitation of the local communities and taken advantage of the cheap labour available from the Chinese and Indian immigrants. Initially immigration was encouraged to suit the convenience of the local aristocratic class. When the 1930 census showed that the combined Chinese and Indian population had far outstripped the Malay population causing unemployment among Malays, and with the trauma of great depression, immigration control was introduced in 1933. The immigrants were mainly the Chinese and the Indians. By the Second World War, the Malays had regained their numerical ascendancy. The Chinese immigrants were enterprising and knew modern business and, therefore, established themselves well. The Indians fell into two categories, wealthy traders, professionals and white collar employees at the one end and an exploited population of poverty-stricken estate labourers without means of mobility and hope of a better life at the other end. Britain ruled till 1949. In between, during the Second World War, it was occupied by Japan. The Japanese government treated Indians and Malays not as harshly as they treated the Chinese.

Malaya failed to generate a powerful, united, nationalist movement in the years following the Second World War. In fact such a movement did not grow because of the colonial policy of 'divide and rule'. Protection of the local Malays had been the policy even of the colonial rulers. Since independence, such policies have been critical election issues. Malaysia has never been racist, it has been feudalistic. There is no history of slavery or untouchability in Malaysia. If any section of Malaysians has suffered discrimination and social exclusion, it is the tribals. They have derived only marginal benefit from the preferential policies. Mostly the preferential policies have benefited only the middle and upper classes. The creamy layer concept, which the Indian Supreme Court has recently invoked in making reservations more selectively available to those who have not received them, has not been thought of in Malaysia.

Impact of Affirmative Action

The author assesses the impact of affirmative action policies in the US in terms of improvement in the socio-economic status of the beneficiaries. He says that there are few studies of the actual impact. The affirmative action has targeted various minority groups but the main disadvantaged sections are (1) the Blacks, (2) the Native Americans, and (3) women. The author writes:

> The civil rights movement, the Kennedy and Johnson presidencies, federal civil rights legislation, and a remarkable sequence of landmark civil rights judgments by the Supreme Court helped to create a trend which became evident in the actions of state legislatures, the lower courts, public sector agencies, professional bodies, educational institutions, private firms, and the public. Certain leads were accepted as signalling new values and a new perspective on what was acceptable or unacceptable conduct and, as a consequence, there was much voluntary 'affirmative action' on the part of bodies with previously poor records in relation to minorities and women [p. 117].

The Indian Supreme Court has also been very liberal in interpreting provisions regarding reservations but its decisions do not seem to have propelled similar action on the part of the private bodies, which still continue to nurse resistance to employment of dalits, tribals and women. Even today, the Indian Government has not been able to persuade the private sector to adopt reservations in its labour practice. A strong dalit lobby monitoring the execution of the reservation policy in government and public sector organizations has, doubtless, improved the position of the dalits so far as jobs are concerned. Even now, dalit percentage in services continues to be negligible. But stagnation of the economy, increase in unemployment caused by the new economic policy, and the loss of ideology by the political elite reflected through cases of corruption have together strengthened the resistance of the higher castes/classes to the policy of reservation. The fact that N.A. Palkhivala describes the decision of the Supreme Court on Mandal issues [*Indra Sawhney* v. *India,* 1992] as unfortunate [Palkhivala, 1997] is typically representative of the high caste/class bias against reservations/affirmative action. Unlike in the United States, where the Blacks have not merely relied upon the law, but have built a strong movement in favour of equality, the dalits in India have unfortunately not built a strong movement for equality. They have depended rather too much on reservations. This is quite inconsistent with what Ambedkar had visualised. Ambedkar envisioned reservations as a means to equality, the post-Ambedkar movement has unfortunately projected reservations as synonymous with equality. This has sharpened the acrimony between them and the others who see a threat to their own entitlements from reservations. In India, any suggestion for affirmative action in favour of the minorities and, particularly the Muslims, is considered as appeasement or communalism. Considering the marginalisation of the Muslims in services as well as politics, affirmative action to improve their position needs to be considered more seriously. Those who regard reservations in favour of the backward classes as casteist are bound to view reservations in favour of the Muslims as communal. But for promoting greater national integration, affirmative action to prevent such marginalisation would be desirable.

The book is indeed a good contribution in so far as it gives so much information on the subject of affirmative action. It is weak in analysis because the canvass of comparison is vast and it undertakes comparison of the uncomparables.

NOTES

1. Women have been given 33 per cent of the seats in panchayats and municipalities by the Constitution (Seventy-Third Amendment) Act, 1992 and the Constitution (Seventy-Fourth Amendment) Act, 1992, respectively. A similar reservation for women in the lower House of Parliament and the state legislatures is contemplated by the Constitution (Eightieth Amendment) Bill, 1996, which lapsed with the dissolution of the Lok Sabha.

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REVIEW ARTICLE*

ISSUES IN URBANISATION: A TALE OF MANY CITIES

Abhay Pethe

Introduction

Urbanisation is an important - perhaps *numéro uno* - emerging concern in India for very obvious reasons. After all, the urban concentration of the third world population in general and India in particular has been growing at a tremendous pace (too rapid for some). So that especial attention to the concern of urban problems is urgently called for. It is in this context that the work, in relation to which the current article is written, assumes importance. It is a collection of papers and articles written by a budding young scholar, Vibhooti Shukla, who tragically is no more. This inevitably means that even when one is being critical, one cannot help but feel a certain sense of poignant loss and sympathy that hence must pervade our treatment.

The work covers a fair ground in the vast area of urbanisation and yet there are serious omissions which I shall mention a bit later. Perhaps one of the reasons (apart from the fact of one's own choice and the fact that one can only do so much) is that, implicit and explicit tenor of the book is dictated by quantitative approach to the problems. It is true that there are limits to this methodology, yet where it treads it does with rigour and clarity so that one is not kept guessing as to what precisely is being argued. This is in stark - and, we may add, not unwelcome - contrast to the other writing in India on the subject which has been largely verbose. What we do now is to kick off, by providing an entrée into the subject matter so as to provide a perspective within which to situate the 'urban issues'. We then turn to the book for a selective review, and intersperse it with our (sometimes lengthy) comments. In the end, we dwell on the crucial issues related to slums, throwing in an illustration of Mumbai. We believe that without a discussion of slums, no treatment of urbanisation can even begin to pretend to be comprehensive.

General Issues: A Backdrop

Urbanisation has always been positively associated with economic development. Urban area is not merely a place with high population density and an absolute population above a specified magnitude. It entails a specific attitude and 'culture'. The concomitant social and institutional structures essentially emerge as a necessary consequence. Urbanisation when viewed narrowly however, refers to the process of positive movement over time, in a country's urban population. As per some rough estimates available, nearly half of the total people in the world are urban dwellers. One of the crucial features of the trend in urbanisation the world over, has been large agglomerations or the coming into being of the so called mega-cities. These mega-cities have been continually changing in their characteristics and to some extent their nature. The number of metropolises has tripled the world over in the past thirty five years [Dogan and Kasarda, 1988]. Projections indicate that there will be over five hundred by the year 2010, and thereafter forty more will be added every five years. The metros in developed world are expected to increase modestly from 110 in 1985 to 128 by the year 2000 and 153 by 2025. In contrast, those in the Less Developed Countries (LDCs) will grow from 146 in 1985 to 279 in 2000, to 374 in 2010 and are projected to rise to a massive 486 in 2025. Thus in 75 years (since 1950) metros in LDCs will grow 16 times! Also the large agglomerations will be concentrated in developing countries (114 out of the 135 the world over). Of late however, there is a discernible shift in the pattern of growth in urbanisation. While the pace of urbanisation continues in Africa and South Asia, it has begun to slow down in the Middle East and especially Latin America due to various factors, some of which we will touch upon later. The good news, therefore, is that while the urban city growth continues in the third world cities, the acceleration

Abhay Pethe is Professor in the Department of Economics, University of Mumbai, Mumbai 400 098.

* *Urbanisation and Economic Growth*, by Vibhooti Shukla, Oxford University Press, New Delhi, 1996, Pp xvi+483, Price: Rs 595.

is clearly reducing. The 'plateau' will hence be reached at much lower levels than earlier feared [Paddison, et al., 1994].

As the twentieth century draws to a close, massive developments in telecommunications and the ascendance of information industries have led analysts and social commentators to proclaim the end of cities. Cities, they tell us, should now be obsolete as economic entities. Of course, this is not entirely true, for, while it may be true that the nature and characteristics of a city may undergo a change, it must be realised that whether it is globalisation or integration, there must be a place where the work of globalisation gets done. Furthermore, information technologies (industries) require vast physical infrastructure containing strategic nodes with hyper concentration of facilities. After all, even the most advanced information industries have to have a production process. Once this is acknowledged, there is no way to keep out secretaries and cleaners! Thus despite the deeply entrenched image of a global city, thanks to media, the importance and the spatial dimension of major global cities ought not to be forgotten.

Major cities that may be termed as global cities, have been centres for world trade and banking for centuries, but beyond these long standing functions, today's global cities are command points in the organisation of world economies; key locations and market places for leading industries and major sites for production, including production of innovations [Sassen, 1994]. The new empirical and theoretical trends have made cities prominent once again in most social sciences. Cities have re-emerged not only as objects of study but also as sites for the theorisation of a broad array of social, economic and political processes central to the current era: viz., globalisation, international migration, the emergence of specialised services and finance as leading growth sectors in advanced economies, and the new type of inequalities. Thus, present day global cities have becomes sites of immense economic power. The once major manufacturing cities may suffer an inordinate decline.

The Book

The book under consideration is entitled *Urbanisation and Economic Growth.* Apart from the quantitative method that runs through the entire book, much of the theoretical apparatus is provided by the idea of 'agglomeration effect', which Vibhooti Shukla had worked on as a Ph.D. student at the Princeton University. The essential idea is easily conveyed. Clearly, for firms, producers and even consumers there are advantages in being close to other firms, producers and consumers. Thus, it is more profitable for firms to be located in cities with large population rather than in sparsely populated areas. The extension of the idea, that when a city becomes too large there can be a negative effect on firm's productivity, leads to the idea of negative agglomeration effect. Thus, the analysis here has important implications for the city size.

The book has been divided into six sections, viz., (i) City Size, Productivity and Policy Implications, (ii) Agglomeration and Migration, (iii) Sectoral Versus Spatial Considerations, (iv) Urban Structure and Employment Dynamics, (v) Consequences of Urban Growth, and (vi) Research Agenda. Some of the papers have been individually written by Vibhooti Shukla whereas some others have been co-authored with eminent scholars in the field. Obviously, the treatment of the work in this article has not been uniform. Apart from the allowance for one's own biases and interests, the overriding concern has been the relevance to the Indian situation, thus some of the chapters on Sub-Saharan Africa and the Texas experience have been treated rather cursorily, except for the general implications or lessons that they may have for the Indian case.

City Size, Productivity and Policy Implications

The first part is divided into four chapters dealing with different aspects of city size including infrastructural requirements. It is widely recognised that there are certain kinds of activities that are most productively carried out in an urban environment. The term agglomeration is used to describe the risk-spreading opportunities of denser markets and the informational advantages that accrue to a firm located in close spatial proximity to its customers, suppliers and even competitors. The concept is used to encompass both the size and concentration. Economists have characterised this advantage as being technological in nature, further it is assumed to be neutral in character.

Agglomeration economies have been empirically verified for the US as well as other countries. Sveikaukas [1975] and Segal [1976] estimated a 5-6 per cent increase in productivity with every doubling of urban size. Shukla [1988] working with Indian data, measured an average of 9 per cent increase in factor productivity achievable upon a 100 per cent increase in city size, corroborating the presumption that the economies are even more relevant and important for less developed economies like India. Shukla's results imply that city with a population of 100,000 can be 23 per cent more efficient than one with 10,000. They can be 51 per cent more efficient for a million city as compared to a city of 10,000. There is one problem here, one must wonder, whether the author has got her causation right. Could it not be that highly efficient and productive urban environs lead to large clusters? There is nothing by way of either verbal evidence or statistical tests provided to suggest that Shukla has after all got hold of the right end of the stick.

It is well known that developing countries including India have had policies affecting the location of industries. These measures are termed as 'industrial dispersal' policies and are meant to increase the contribution of the various regions to the national output. It is important to be clear about the target where these policies are aimed, the avowed objectives and the instruments being used to implement the policies.

In constructing a theoretical model for a region, the aggregative representation of the region's productive possibility is : $Q = G(N) F(N,K)$ (N: Population, K: Capital) where G(.) and F(.) are the technology's external (those governed by change in technological knowledge) and internal (governed by change in technique, given technological knowledge) components, respectively. $G' > 0$ indicates that the agglomeration economies are present whereas F exhibits decreasing returns to scale. The decision problem leading to the determination of the equilibrium urban size in the region is given by : Max. $G F(N,K) - wN - rK$, (w: wage rate; r: interest rate) since individual decision maker treats G as being constant. Here the output price is normalised to one and $w'(N) > 0$, which reflects the disamenities of scale as also the cost of attracting migrants from afar. All the behavioural traits are captured by the wage function and no separate utility function is provided. The stage is now set to discuss the private equilibrium level of city size as an aggregate of employment functions of private firms and hence arrive at the implicit optimal city size. On the other hand, it is now possible to take into account the agglomeration effects and work out the social equilibrium and then compare the two equilibria. Intuitively obvious and hence none too surprisingly, the conclusion that emerges is that the social equilibrium is greater than the equilibrium size implied by the private considerations. This as a consequence has important implications for migration, for the suboptimality of size leads to suboptimality of migration rate and size.

As an important application of the model we have the considerations of infrastructure deficiency and the consequent implication for the dispersal strategy. The region is defined as backward if it is deficient in infrastructure. Lack of infrastructure is seen as a general institutional barrier to the development of the region. The governmental social welfare function, which is required to specify the advantages due to the removal of the barrier (or lessening of it), is characterised by expansion in industrial employment.

After all, infrastructure investment in any region is bound to have unambiguous rewards. But while there are a number of areas where fruitful intervention is possible and a variety of actions which are feasible, a non-trivial decision problem arises because the government resources are indeed scarce. Under the specification of the problem it is seen that there is a case for diversion of resources from region A to region B provided the divergence between the 'optimal' social and private size in B is greater than the similar divergence in the region A. This as a corollary leads to some trivial results that are definitionally self-evident and some others that provide bench-marks. These bench-marks can then be operationalised and econometrically tested using real life data. An important proviso has to be entered here: the optimal size (whether private or social) as obtained here as well as the case for specific intervention may be invalidated if the implicit social welfare function disfavours large agglomerations for administrative, political or any other reasons. Whilst this is a serious limitation of this study under review, the fact that it is explicitly recognised means that the arguments for or against may be clearly set out in a discrete and hence more meaningful fashion. Thus, in a situation with agglomeration induced externality, the correction must be brought about by a government financed intervention. Independent of the target identification which was the concern thus far, the optimal instrument selection is the present issue. Using the same simple model and neo-classical presumptions, and concerning one with a single region problem, it is possible to do a bit of algebra to compare and assess the relative efficiency of different instruments, specifically the labour versus capital subsidy. The results show the capital subsidy to be consistently dominating the labour and output subsidies. Within the plausible range of parameter values, it is seen that the capital subsidy is about 20-35 per cent cheaper than labour subsidy for attaining optimal employment levels. Moreover, these values are seen to increase with agglomeration elasticity. Important as they are, in appreciating these results, it is necessary to bear in mind the strict limitations of the neo-classical assumptions made, also the narrow objective function being used. Given these, of course, the results continue to be illuminating bench-marks if used carefully for deriving real policy measures. It cannot be overemphasised that important as such analytical studies are they provide bench-marks. Thus, it is not at all straightforward to cite (as is done) this paper in the book under review and argue that all calls for stopping the influx in a city are wrong. One has to remember that the result is true only under strict assumptions and on techno-economic criteria. Of course, the onus of showing why in reality these will not hold must now fall on the other party in argument and that such a paper exists means that argument can be so much precise. A similar point of method may be made about the result about the superiority of capital subsidy. After all, in actual practice, in evaluating a system's performance, one should consider the aspects of equity, efficiency and adequacy so that the result reached on the basis of a narrowly defined objective function may not be extended in a straightforward fashion to the real world.

The book now turns to an empirical exercise on the sources of urban productivity and city sizes. The relevant chapter is broadly divided into three parts. The first deals with a direct estimation of firm production function, taking into account the agglomeration influence. The second part deals with some microfoundational issues as well as looks into the 'wage-size relationship', whilst in the third part, the localisation hypothesis is put under scrutiny. The chapter mentioned earlier places a technological interpretation on the urban agglomerative advantage, in consonance with the theory developed, which whilst imparting precision to the concept, narrows its meaning to some extent. The agglomeration estimates are derived at the industry level, using the firm level data derived from financial statements. There are three advantages in working with firm level data. First, this is superior to aggregate data for recovering parameters of production technology. Second, it may be possible to uncover sources of economies enjoyed by a unit due to location. Thirdly, firm level disaggregation represents the best level of data for ensuring exogeniety from an econometric point of view. Different specifications of production function are used to derive the estimates, such as the constant elasticity of substitution (CES), the variable elasticity of substitution (VES) and indirect estimation. For each of these different functional forms are used. The estimates thus obtained uniformly show higher values than those reported internationally, especially for US. But that is quite intuitive and indeed obvious. A growing developing economy would yet not have reached a stage where the diminishing returns have set in as against the case of developed economies which have stabilised, save for the sudden shocks due to technological breaks. Also the results reported are rather weak, in that only for two of the five industry classifications one finds an inverted U which is required for calculating an optimum size. In any case the results reported as well as the framework for formulating the questions provide a useful framework for conceptualising and contextualising a firm's optimisation problem, in respect of location decisions in a manner compatible with macro formulations such as the equilibrium city size. Next the attention is turned to whether it is the localisation or the urbanisation economies that predominate in a developing country. One major problem here is the presumption of being able to distinguish between pure urbanisation and localisation, using the simple production function model given earlier. Using standard procedures, it is seen that any localisation influence is meaningfully discerned only for two industries viz., 'Basic Metals and Alloys' and 'Manufacture of Transport Equipment and Parts'. All in all, it appears that the localisation influence, at least as captured by the narrow localisation variable used, viz., industry size, is very small in Indian cities compared with the more dominant urbanisation influence. In fact, one would suspect that these issues cannot be really looked at (leave alone settled) at the present juncture. The urbanisation process in India is far from near completion and as such any such inquiry is bound to fetch garbled results. Only after some stability is acquired in the process that econometric estimation will yield meaningful and stable parameter estimates.

The next chapter concerns itself with population redistribution in sub-Saharan Africa and the policies pursued and institutional structures emergent in that region. I shall give this well-argued piece only a glance since in my reckoning it does not offer any useful insight in studying the Indian situation. The article begins by posing the problem: Is there an objective way to determine optimal population distribution? It is pointed out that there need not necessarily be any superiority attached to a spontaneously arrived at distribution of people over space. The neo-classical free flows do not always emerge and a persistent spatial mismatch may arise due to immobilities, regional preferences and incomplete information. Governments alarmed at the erosion of already inadequate infrastructure, have both through exhortation and statutory measures tried to discourage an accentuation of what was believed to be unsatisfactory urban trends. City systems have been characterised in a negative way as being primate, non-generative and parasitic.

As a component of productive infrastructure with the most explicit and pervasive spatial impact, transportation merits special mention. What mix of private and public sector financing is to be used has implications for subsidy component contemplated. A situation of no accountability or recovery will lead to disuse and wastage. Above all, social investment in health and education is very important and a general moral to be learnt is that concentration should be in areas with maximum multiplier effects and linkage possibilities, and that design of policies has to be incentive compatible rather than coercive. The book now turns to the more general issue of urban infrastructure and productivity.

Investment in infrastructure represents the most potent instrument available to governments at all levels for promoting economic growth especially in the developing countries context. Spatial specificity is important. The relevant paper aims at empirically exploring the contribution of urban infrastructure to economic efficiency within a regional production framework. This is a detailed study looking at 60 items using urban district level cross sectional data in the year 1976-77 for the state of Maharashtra comprising then of 26 districts. There are several interesting conclusions emerging from this study. If it is desired to obtain more accurate measures of the relative contributions of various specific infrastructural components, it is advisable to use physical rather than financial infrastructure proxies. This enables purer formulation of public infrastructure as an input, and can provide a more explicit guide to regional policy making. The sub-components of several infrastructure categories contain both capacity as well as utilisation variables. Some useful insights about congestion or under-utilisation may be obtained by examining the relative success of each kind of index. It is observed, by and large, that with economic infrastructure, utilisation index coefficients fare better than those on capacity measures. For example, water consumption is better than length of the pipeline, or public transport service routes better than length of urban roads. This superiority of utilisation coefficients is reversed whilst studying the social infrastructure, with number of public hospitals performing better than number of patients in public hospitals. Also different technologies matter, thus asphalt roads are better than total urban roads, i.e., they contribute more to regional productivity. The results are indeed very revealing. The positive sign of many of the elasticities of substitution indicate that infrastructure and private inputs are, by and large, substitutes. Moreover, in general, the elasticities between infrastructure and capital are higher than those between infrastructure and labour. Two points need to be made in this context. One, that numbers alone are not enough to provide useful and relevant results, but they certainly provide a basis for asking relevant questions. Second, whilst there is a great deal to be said for this exercise at this level of aggregation, a further dis-aggregation would lead to added utility. It is undoubtedly true that one cannot do without indices, but perhaps one needs to consider a specific urban area, look at its production structure and identify the kind of infrastructure that it needs. This information would lead to assignment of relevant weights in the construction of an index. Such an index, one would daresay, be more policy potent as well as more useful as an evaluative device.

Agglomeration and Migration

In this part of the book, optimal migration, policy ranking and the scrutiny of Harris-Todaro paradigm are dealt with. In the opening paper, it is demonstrated, that it is possible to utilise urban economics to identify socially optimum levels of urbanisation and by implication, optimal levels of rural-to-urban migration. A 1983 United Nations survey of 126 governments of less developed countries found that all but three small island nations did not consider the distribution of their populations 'appropriate': more than three quarters stated that they were pursuing policies to slow down or reverse internal migration. These policies do not have a remarkable success record. May be that this lack of success is due to the fact that side by side with congestion and pollution, there are remarkable agglomeration economies to be reaped, conferred by urban concentration.

Although the capital subsidy is cheaper than the output subsidy, the difference between capital and labour subsidies cannot be signed analytically, that is, one cannot determine a priori whether the difference between the capital and labour subsidy has a positive or a negative sign and this is a purely empirical question contingent on specific data at hand. Fortunately, simulation experiments under plausible conditions can be conducted which yield interesting insights. Based on earlier research and complemented by work reported here, it is concluded that subsidising capital utilisation may be a more efficient means of bringing about socially optimal levels of industrial production, urban concentration and rural to urban migration. Thus the important insight here has to be that although migration is a labour market phenomenon, an optimal response there may be got by intervention in the capital market. This is akin to the view that in certain cases, a rupee spent in rural area may be more beneficial for urban situation than the same expended in the urban area.

Urbanisation processes and the impetus for city growth in LDCs continue to attract much interest. Underlying this interest is the recognition of the empirical association between urbanisation and economic development. Also of interest are the policy concerns with the problems of cityward migration and urban unemployment. The many variants of the Harris-Todaro model (1970) have addressed the issue of migratory responses in the face of sector specific institutional rigidities and the consequent inefficiencies, have ignored the tremendous 'pull' exercised by the economies of urban agglomeration. This relevant paper incorporates the agglomeration economies in the dualistic model of a developing economy. Simulations of the model specified under expenditure-income frame are carried out. Having considered two intervention options, uniform wage subsidisation and differential optimal wage subsidisation, a welfare superiority of subsidisation with attention to agglomeration economies, as against that ignoring such effects, on the grounds of both cost as well as benefits, is established under plausible conditions. Even where cost superiority is not demonstrated, it may still be the case that the benefits outweigh the increased costs. Analytically, the presence of agglomeration economies breaks down the previously construed optimal prescription involving equal subsidisation across sectors even when they are characterised by expected income-led migration and calls for a higher rate of assistance to urban as against the rural productive activities. This must surely fly in the face of those who consider the urban activities as being largely parasitic in nature. The nature of models constrains (necessarily) the kind of results that are achieved. Also the stringent assumptions in the analytical exercise mean that the results have to be treated with caution, at least so far as robustness of the results to more general setting is not established. Three further research areas are mentioned. One, the microfoundations of agglomeration economies are to be investigated. Two, the financing sources and administrative costs are to be explored systematically. Third, the legitimisation of urban informal sector and rigidity of the wage rate for formal sector.

The book now turns to the question of the coexistence of high wage rates and unemployment in the urban labour markets of LDCs. By and large, this simple question has not been properly answered or discussed in either development or migration literature. The standard approach has been to blame the high wages on institutional factors. The question then must arise, that if the framers of wage legislation are aware of expected income model and if they believe that agent behaviour is indeed captured by the model, then such a institutionally hiked wage will lead to further increase in migration and hence unemployment. This result is further strengthened when it is realised that the firms will switch over from high cost regimes (artificial) and shift away to places where the wage costs are lower. A more plausible explanation is the so-called efficiency wages which will be above the market clearing levels. In all this it is important to realise that many of the productivity gains that arise from the fact of urban labour force being larger than the employed, are external to the individual firm and are related to agglomeration economies. These considerations are clearly in contradiction with the more standard paradigm, viz., the Harris-Todaro model whose variants all crucially depend on the assumption of rigid urban institutional wage, which in combination with the postulated expected income-migration response leads to unemployment. The relevant paper contains a fair amount of analytical work, albeit within the standard neoclassical micro foundations framework. Whilst the analysis serves to establish a consistency between the dualistic urban wage rate postulated in the expected income-migration model, with an agglomeration economies explanation, it stops short of fully explaining the formation of the institutional wage rate. For that, the model will have to be broader and cast in terms of rational behaviour of firms. The current paper thus provides a synthesis and an explanation of stylised LDC urban labour market phenomena such as dualism and institutional wage rigidity. It is also provocative, thus providing intermediate insights that should invite fresh research in several related aspects. Perhaps at this juncture, a detour concerning the informal sector (which gets only a marginal treatment in the book) may not be out of place. The paper in the book looks at this sector from the firms' point of view, but there is also a case from the viewpoint of the members of the so-called informal sector.

Informal Sector

The heterogeneous nature of urban economies is well documented in the literature. At the risk of simplification, it has been suggested that there are two parallel sectors of activity, which provide employment to the urban labour force. These two streams are popularly labelled as the formal and the informal sectors. The enterprises in the informal sector are hypothesized to have virtually no access to credit, skills or technology from private or public institutions, such as banks, training institutions, etc. In reality, there is no such clear cut demarcation and there is always an overlap, leading to a continuum [Sethuraman, 1976].

Informal sector was attempted to be defined for the first time by an ILO mission which studied employment situation in Kenya in 1972 [Hart, 1973]. Yet, the term informal sector has eluded precise definition because there is no agreement on the nature and characteristics of the informal sector. Far less is there an agreement on the role it can play in the development of an economy and the measures needed to develop the informal sector itself [Mujumdar, and Lall, 1992; Lall, 1989]. Various appendages like unregulated, unregistered, residual, peripheral and self employed sector have been used to describe this sector. In the past there had been a neglect of this sector perhaps due to the perception that it is too amorphous. The one area of consensus is that the existence of 'informal sector' is inevitable in the context of an urban industrial economy. Further there is a recognition that activity in this sector is decidedly not in the nature of an 'apology for employment' but is most of the times viable and may indeed occupy a position comparable to any productive activity in any of the other sectors in the economy. Indeed, activities in the informal sector arise as a response to the perceived or felt demand in the market. One study that makes a distinction between formal and informal sector [Bapat, 1992] clearly states as follows: 'The possibility that the informal economy with its emphasis on tertiary activities, may be developing at a rate faster than other sectors of the national economy and thus taking up some of the slack created by inadequate growth rates in well documented modern sector, cannot be dismissed on *a priori* grounds. When half the urban labour force falls outside the organised labour market, how can we continue to be satisfied with economic indicators of economic performance which ignore their productive activities?'. The pertinent question raised in this context is whether we want to shift the emphasis of income opportunities in the direction of formal employment for its own sake and, if so, how or only to reduce the proportion of socially disapproved informal activities in those activities where the marginal productivity is too low? In view of the limitations of the earlier classifications (dualistic, organised/unorganised, etc.) the dichotomy between formal-informal was regarded being both, meaningful and convenient. Here the concept of the 'informal' sector, one has in mind, refers to 'the small and unprotected producers in the urban economies who on account of being in disadvantaged position are unable to derive the benefits of development and contribute to the process of development to the full extent of their potential' [Mitra, 1994]. Yet they undoubtedly form a crucial and substantial part of urban economies [Papola, 1981]. In all this is implicit a plea for providing a 'level playing field' (a phrase popularised by domestic entrepreneurs in the context of globalisation) *vis-a-vis* the formal sector. For, in dichotomising, we must not lose sight of the total production system with the provision of a range of functions from credit availability to marketing promotion, otherwise we would have lost an opportunity to augment the capital accumulation emanating from this sector.

We may say that sluggish industrialisation and bias for labour saving technology restrict the process of productive absorption of labour. Sustained growth of income originating from organised activities may raise the overall growth to reasonably high level, but it does not cater to the need for productive income generation of unskilled variety of labour. This gives rise to informal sector activity, characterised by low capital intensity, high degree of competition in the product market, small operational units and unskilled nature of labour which generate meagre earnings. Urbanisation as mediated by the growth of informal sector is accompanied by urban poverty on the one hand and growth of slum and squatter settlements on the other [Mitra, 1994].

Rural Urban Shifts

Immediately after this paper is a review article written by Vibhooti Shukla on a related theme: 'Rural Migration to an Indian Metropolis: Examining the microfoundations of the Harris-Todaro Paradigm', review of a book by Biswajit Banerjee, which is a case study of Delhi. Theoretical development of the migration model due to Harris-Todaro [1970] has come a long way. Taking into account many obvious facets of LDCs, it rapidly proved to be an attractive alternative to Lewis' model. The model's solution features an economy in underemployment equilibrium, which is off its production efficiency frontier, as a result of harbouring a serious intersectoral misallocation of labour resources wherein a part of the rural labour force removes itself from productive agricultural activity and migrates to urban areas. In general there are four sub-hypotheses which are on trial: (i) migration is a response to the rural-urban difference in expected income. (ii) The would-be migrant experiences job uncertainty in particularistic terms whilst enjoying general information regarding destination employment possibility. Thus he is precluded from the rural job search and encouraged to seek an urban job. (iii) The informal sector is a residual sector. (iv) There are institutionally determined high wages which fail to equalise the formal-informal wage-rate through market clearing.

The dominant reason advanced for migration is the absence or inadequate economic opportunity. To infer from this that rural development effort or investment in rural income generating activities will stem the tide of migrants, a classical Harris-Todaro prescription, will hold only if only the poorest migrate (which is not the case!). Thus, for example, the assumption that rural folk migrate on the basis of general information and search for specific opening does not hold for the case of Delhi. The study vindicates urban growth through migration as being privately welfare augmenting and not merely the result of mass miscalculation. By and large, it appears that the rural migrants know what they are doing when they make the move. Compelling evidence of migrant rationality must call into question the view of migration as social cost and private mistake. Also, the value creation is not limited to formal sector alone but extends importantly to informal sector too, as we have already noted. In considering the rural-urban shifts, one gets the lurking suspicion that according to the view under scrutiny somehow (a) it is a negative process, and (b) that the rural folk are to be blamed for this 'irrationality'. To set the record straight about the reviewers own views on the subject, it might be pertinent to say a few words.

It is common knowledge that considerable attention has been paid to the rural urban shifts and the consequent overurbanisation. Now, upward income mobility, involving locational, occupational and industrial shifts of the individuals and their incomes, along with progressively better income opportunities has always been considered to be a most important feature of economic growth [Kuznets, 1966]. Of course, the increase in population takes place due to natural causes as well as migration. The demographic features, generally, are such that even a decelerated influx of rural workers leads to the vexing problem of productive absorption of labour force [Todaro, 1976]. It is now well recognised that both the 'pull and push' factors are operative [Sundaram and Tendulkar, 1988]. As an offshoot of rural-urban shift is the overurbanisation thesis, which had considerable currency during the decade of 3.9 per cent growth in urbanisation, even in India. This thesis propounded by Hoselitz [1953, 1957] and Bairoch [1975], noted that the share of industrial employment of the third world countries was unusually low as compared to the historical experience of the currently developed countries [Sovani, 1966 and Williamson, 1988].

Davis and Golden [1954] examined the relationship using cross sectional regression and outliers were interpreted to have overurbanised. The emergence of this mismatch between industrialisation and urbanisation in Asian countries came to be interpreted as 'overurbanisation'. The main cause of overurbanisation is to be traced to the increasing pressure of population on the farm land in a densely populated agrarian economy. It is clear that if urban area is not dynamic then poverty will coexist in both the urban and rural areas. Rural migrants pushed into cities are forced to engage themselves in the informal service sector in the face of sluggish prospects in the highly paid industrial segment. One recommendation favours rural restructuring for labour absorption. In a similar vein, Biplab Dasgupta has opined that perhaps one way to improve the urban situation and ease the strain on delivery systems is to spend more on rural sector. Of course, the industrial growth in the third world countries has not really been sluggish, also there has been a slowing down of influx into urban areas. Indeed informal sector has been put in a disadvantageous position due to the more favourable condition available to the modern economic activities. State help - mainly political will - is thus required to create a level playing field. This image is in contrast to the image that emerges from the overurbanisation thesis.

There are a plethora of loose ends., e.g., does it mean that slowing down will help? There has been no evidence to support this. Indeed, the fact of slowing down has not elicited any positive response from the academic experts. The premise of excess labour supply caused by influx of rural migrants runs, as Kannappan [1983] argues, the 'risk of sweeping the urban ills under the rural carpet'. According to him this requires the assumption that the rural-urban transfer is an irrational process. Even if there is no immediate possibility of absorption of the rural migrants into gainful formal activity, they will continue to stay (as we have argued earlier) if there is a possibility in the near future, for, from their point of view, unemployment or under employment would be transient in nature, especially when they do not have a possibility of earning more in the rural area. Unfortunately, one of the consequences of this influx, given the lack of provisioning, has been the concomitant creation of slums, to which we shall turn at the end of this paper.

An important point needs to be mentioned in this context. Whilst it may be worthwhile to see the rural urban wage differentials and focus on the income strata of those actually migrating, it will not explain the whole picture. There are different motivational forces operating for different agents, further there is a community based networking that is operational, which leads to a chain of migration. Further urban areas work as 'reservoirs of hope' which play a crucial role in this process. It may be pertinent to quote Ignacy Sachs who says, 'they (cities) work as gigantic Las Vegas, in the sense that bulk of them are gamblers. Except that games are different. The rewards may look insignificant in terms of high price of tickets, in terms of daily life difficulties, the important thing is that there are rewards for some. The large cities are places of hope while the drudgery of life (in their rural situation) looks hopeless' [Dogan and Kasarda, 1988]. These then become important considerations if one is to fathom the reasons for migratory behaviour. Hard traditional modelling, however rigorous, will be of no avail.

Sectoral and Spatial Considerations

The author now turns to sectoral versus spatial considerations. This part has three articles of which the first one is on 'Pace of Indian Urbanisation'. The paper begins by critically looking at a model proposed by George Tolley [Tolley, 1984; Tolley and Thomas, 1987]. He proposed a simple supply driven urban growth model for the two-sector economy of a country closed to foreign immigration and to emigration but open to trade in commodities. Contrary to the 'traditional' income elasticity driven view of development and urban growth, that emphasises domestic demand factors and makes prices endogenous, Tolley sets out to enunciate a more general explanation, one applicable in the international trade setting where countries could be considered to be price takers.

A crucial prediction of the conventional model of urbanisation has growth in urban productivity leading to less, and that in non-urban productivity to more, urbanisation, spatially. Given that rising productivity in urban areas enhances cities' ability to compete in international markets and to compete with production in rural areas, Tolley claims that the idea that urbanisation is primarily explained by massive changes in relative prices of urban goods is not appealing. The present paper by Shukla is an attempt to extend the Tolley model and verify its relevance and validity for India. The whole of India and at a more dis-aggregated level her states are subjected to empirical explorations. Detailed study using the Indian data reveals that only for three states, viz., Maharashtra, Rajasthan and Uttar Pradesh, do predictions conform to reality. The thrust of the results of the state level simulations indicate a widespread overprediction which is in conformity with the result obtained in the national level exercise. In order to explain the deviation of reality from the model predictions, reasons from several broad categories may be considered, e.g., (i) structural economic factors are not considered in the model. The wage equalising labour force transfer mechanism of the model may not be realistic for India. Several structural factors may be present which account for non-uniformities in mobility propensities amongst different states. General economic backwardness, institutional dualism, rigidities in asset and labour markets can render the rural population inoptimally mobile from a strict productivity view-point, resulting in either excessive or deficient flows. (ii) Sectoral complexity is not accounted for by the typical analytical classification. While it appears that rural poverty and landlessness contribute to the unproductive urbanward migration, agriculture is not the sole employer in the rural areas. Indeed, agriculture and manufacturing do not exhaust the possibilities of employment in either the urban or rural areas. (iii) Public policy intervention and its impact are not considered. A reasonable course of policy might be to encourage rural non-farm activity in the overurbanised states, whilst letting the natural forces of urbanisation responding to intersectoral productivity differentials in those that are not.

Whilst it is possible to evaluate the performance on the basis of the predictability, the other way is to normatively rationalise the results, keeping in view the restrictiveness of the model assumptions and, hence, its optimality. Whilst it is true that alternative traditional explanations do not fare too well either, it is of little solace and the conclusion is inescapable that there is a real need for realistic analytical extension of the model in its empirical manifestation. The simplistic two-way classification of employment avenues is simply not rich enough to capture the complexity of reality. However, it does serve as a useful benchmark for a starting point of useful analysis.

The second article is concerned with the rural non-farm activity and is an empirical analysis of the case of Maharashtra state. The rural non-farm sector in India has been growing in aggregate size and appears to have a significant impact on the augmentation process of the rural non-farm income. This is important to note, especially, since most dual economy formulations, be they guided by growth or equity considerations, oversimplify the spatial dimension of economic development by locating the non-farm activity in urban areas. Here, the rural non-farm sector is perceived as regional labour market competing for labour with the spatially coterminous agricultural sector and the physically removed urban sector that is linked with the rural through labour migration flows. The paper then goes on to conduct both static and dynamic estimations using several relevant variables. The contribution envisaged from this paper to the study of non-farm sector has been primarily one of offering a paradigm to examine the substantive issues relating to rural non-farm employment in a regional framework that explicitly emphasises the role of sectoral and spatial dimensions in affecting rural labour market flows. Where the theory was absent or ambiguous, several substantive insights have been afforded by the case study analysis here. One could not agree with the author more when she asserts that: 'A challenging research agenda awaits'.

The third article from this part deals with the rural non-farm employment in India: Issues and Policy. The rural non-farm sector is expected to feature in sectoral policy debates regarding 'immiserizing' agricultural growth and calls for the rapid diversification of rural economic activities away from agriculture, as well as those relating to the consequences of alleged 'urban bias' in policies. This area of research assumes added importance when it is recognised that it is physically impossible that the structural transformations that accompany economic development will be articulated through massive movement to the cities. Agricultural and labour market linkages are investigated by Vibhooti Shukla using four crucial variables, viz., consumption, production, migration and labour force. It is seen that the consumption linkages are by far the most strong and significant. The production linkages (backward, via the processing industry) are rather weak. The rural in-migration rather than out-migration shows the greatest affinity to non-farm employment growth. Generally, strong spatial consumption linkages are seen between the agricultural and non-agricultural subsectors of the rural economy. This observation that consumption linkages are stronger than production linkages is not peculiar either to this study or to this country. Finally, it is found that emphasis on efforts to support industrialisation in already well developed areas may yield higher pay-offs (first law of development in operation). It is also noted that substantial rural employment in manufacturing does not spontaneously take place in rural areas in the presence of more competitive urban locations. To the extent this is artificial, corrective policy measures are called for. In respect of infrastructure provision, one of the most efficacious instruments for generating overall non-farm employment growth appears to be capital expenditure on major irrigation projects and roads which should not surprise anyone.

City Structure and Employment Dynamics

This part of the book deals with city structure and employment dynamics. We will not deal with this part in too much detail as it is purely technical and pertains to a Western city, viz., Dallas Fort Worth, which provides little insight for the Indian situation. The treatment here is reminiscent of the work of Jay Forester [1975].

The first article looks at firm location and land use in discrete urban space and tries to answer the question about the implications of intra-metropolitan firm location choices to the urban form. An understanding of employment decentralisation is central to the understanding of the 'new urban form'. An innovative feature of the study is that it seeks to account for multidimensional spatial interactions in a way not possibie in purely monocentric approaches to the problem. In fact at the end of all the technical and theoretical arguments the conclusion that emerges is that polycentric or multicentric approaches are the only meaningful ones, so that one can no longer follow the traditional method of identifying central business district (CBD) and look at suburbs as residential extensions. This is clearly the unifying theme through the article which links the employment (spatial) dynamics to business cycles, and shows how the employment gravity is clearly to the north of CBD in case of Dallas Fort Worth. The tale of centre city decline is statistically as well as graphically worked through in the final article of this part, which is too specific and hence of limited interest to us. That brings us to practically the last part of this book. That is because the very last part is largely speculative in nature dealing with the thinking of the author about various issues, the research agenda as yet unfinished, et al. Though this gives insights into the working of a creative mind of a young bright scholar that Ms Vibhooti Shukla undoubtedly was it contains no concrete research and as such will be given a go by.

Environment, Energy Use and International Agreements

This part deals with the relevant and controversial issues of environment, energy use and international agreements. The first article in this part deals with the environmental consequences of urban growth and seeks to provide a cross country perspective. There has been a strong revival of interest in environmental matters in developed countries and a long overdue recognition of environmental problems in countries that have come late in the development game. World Resources Institute, in 1989, characterised six urban trends that are supposed to be important in considering environmental problems arising out of human settlements. They are as follow: (i) The proportion of people living in urban areas is increasing. (ii) Urban population is increasing at a higher rate in LDCs as compared to the developed countries. (iii) In the LDCs, large absolute number increase is expected in urban dwellers. (iv) The number of cities in all size categories are rapidly increasing in LDCs. (v) The megacities are growing faster in LDCs while the rate of growth of megacities in developed countries is on the decline. And (vi) the distribution of people living in absolute poverty is shifting from rural to urban areas. Whilst one may not question the growth in urbanisation and industrialisation in these countries in their quest for higher standard of living, it may be pertinent to ask if the attendant changes are desirable or costless. This paper attempts a quantitative assessment of the environmental consequences of urbanisation in general and city bigness in particular. The study also explores the local impact of urban pollution by comparing the ambient air quality over various zone types. After all, the LDCs are now thought to hold potential for much greater pollution than is anticipated for developed countries, given that the former have a long way to go in the path of industrialisation. Since it cannot be assumed that the developing country strategies for combating pollution will or should follow developed economies, there may be some value in comparing the differences and simulating the two contexts. As already noted urbanisation is progressing rapidly in LDCs.

Empirically, the expansion of non-agricultural production pattern goes hand in hand with urbanisation, since such production is most suited for urban areas. This becomes an important channel through which rising incomes are translated into urban growth. When different proxy variables were used in the context of studying the structural features of the development problems these revealed weak or no association between countrywide emission rates and urbanisation as distinct from effects of incomes, population and share of manufacturing activities. A related observation is that environmental problems are no problems at all when urban densities are manageable. Further research needs to be conducted to find the directly measurable deleterious effect of pollution due to increased congestion.

The World Resources Institute reported air quality in most large cities in developing countries to be far below that of the cities in Western Europe and North America and well below the acceptable international standards for good health. The report noted the particularly poor quality of air in cities in India that are industrialising and depend on wood and coal for fuel. High carbon monoxide and sulphur dioxide levels of automobile exhaust were also noted. Rigorous empirical studies reveal a well articulated inverted U relationship between city population and micrograms of pollutants per cubic meter of air volume, especially for developing countries. By and large, the results confirm the positive impact of urban densities (measured overall city sizes as well as micro level persons per room), with the results being more significant in the case of latter measure. There are however no significant results of relationship between pollutant presence and city sizes, which however in no way diminishes the problem of urban pollution. There are cost effective ways of curbing emissions that need to be in place and quickly, especially in metropolitan regions. Only higher incomes and better knowledge, combined with enlightened policies, will ensure that the incremental pollution in the future will be limited to manageable limits. The book now turns to considering international agreements for global environmental protection.

Early global environmental research focused on the scientific basis for linking emissions to global environmental quality. Only recently has there been a growing recognition of the human dimensions of the subject as well as the role of public policy. The primary purpose of this paper is to develop and test models for understanding of the political economy of behaviour regarding the global environment. The parameters of the empirical model are estimated using a probit estimator. The model implies that the likelihood of voting for an environmental agreement depends upon the national income, the emissions of the other countries, the cost of compliance and tastes and preferences. The approach here is admittedly simple. Yet it is likely to be useful in future environmental negotiations, since it can help focus the bargaining on incentives designed to increase the support for the agreement. There are two caveats to be entered here, one, that international power relations and the specific conveniences of the super power(s) at a particular juncture play a far greater role in the climate in which the lesser (developing) countries are to sign agreements. Two, the use of game theory would enhance the insight of strategic play that is likely to be more useful than the straightforward hard core macro-modelling as has been attempted in this paper. The final paper in this section is devoted to energy use and green house effects in the context of urbanisation in developing countries and presents a cross country analysis. Whilst the methodology used here is essentially a continuation of the earlier articles in this book the results derived are rather trivial and axiomatic. The results of acidic deposition, climate change, stratospheric ozone depletion, third world debt and national security are all exacerbated by wasteful energy use. Finding more efficient ways must be a part of a comprehensive policy package that needs to be negotiated and devised. Here again politics and externality are likely to play a huge role. Thus, again, game theory in our opinion is likely to be more potent tool for analysing such problems. Cities in developing countries face immediate problems due to local rather than global issues. Yet, they must ready themselves to position themselves strategically to extract maximum mileage in international negotiations, earning for themselves the benefit of positive externalities. They need to be treated as equal partners. International organisations concerned with relevant issues and policing global environment and drafting policies thereabout must heed this essential message.

As promised by us at the beginning, we now take up the topic of slums, which in a certain sense, is a necessary consequence of some of the other aspects of urbanisation. We also illustrate the situation with the example of Mumbai city, which is a classic prototype of a megacity in the developing world.

Slums

Whilst, 'slum' as an urban malady originated from the West, the 'avtar' of squatter settlements is perhaps the trade mark of the third world [Nandy, 1987]. Slums basically are an area of worst form of struggle for basic needs of life. They have been allotted the worst quarters of the city. The slaves of Roman times, the workers of industrial dawn, the hewers of wood and the drawers of water have always had to contend with the most demeaning varieties of accommodation [Desai and Pillai, 1990].

It is easy to see that slums are an integral part of the process of industrial development in and around cities. There have been differing attitudes towards slums *vis-a-vis* the academia. At the outset it needs to be mentioned that we believe that the so-called slums are for us not only lively but also places of livelihood.

According to a report of the U.N. on Urban Land Policies, a slum is 'a building, a group of buildings or area characterised by overcrowding, deterioration, unsanitary conditions or absence of facilities or amenities which because of these conditions or any of them, endanger the health, safety or morals of its inhabitants or the community' [Anderson, 1960]. Slums are in some cases, places of residence of criminals or destitutes but this is clearly inessential. We would concur with Bergel [1955] that slums refer to areas and that a single building in the worst stage of deterioration is not a slum.

As noted earlier, there have been differing attitudes and misrepresentations of slum situation. We present a quote to make our point: 'Like dark gloomy clouds hanging over a haunted city, the breath of death hovers over the residents of

[Shantinagar]. But unaffected and resigned to their fate, they hang on to life as long as they are spared, for even if they cry for help there is none to hear. The living dead heave a sigh of relief, tragic though it is, with the passing of their dear ones, because there will be a few more less in the hovel and more room for the rest..... There is nothing like social life for the residents of Shantinagar' [Owen, 1969]. In a similar vein, Clinard [1970] characterises them as, 'overcrowded mudstructures, to be shunned and avoided, because they are evil and strange'.

As against this is the opinion that 'studies and "saviours" who refer to the slum dwellers as living dead and tottering on the brink of starvation, betray a total lack of slum life', [see, Desai and Pillai, 1990]. They further state, that the stereotype image of a slum dweller as lazy, inferior and unintelligent, being resigned to fate and lacking in motivation and thus living in a 'culture of poverty' is a view jaundiced with fetishism of academic categories. Slum habitat, perhaps represents the best possible (given other things) and a rational choice in the circumstances.

Perhaps a word on 'culture of poverty' may not be out of place. From his extensive studies of Mexican and Latin American milieu, Oskar Lewis [1959] came to be well known for this concept. This concept applies to those at the very bottom of the scale of socio-economic ladder. The culture has several characteristics, the economic ones being, 'constant struggle for survival, unemployment and underemployment, low wages, et al.'. Though this has been one of the most critically discussed concept of the decade, it however does not apply to Indian city realisations like Mumbai and we may dare say, does not appear to be an analytically useful concept. Even realistically, they do not display 'isolated subcultures' like ethnic American or China towns. Here there is sufficient networking with the outside world. Another related concept is that of marginality, which refers to a condition that 'excludes a labour force from participating in industrial production, especially due to lack of requisite skills'. This too has negligible relevance if any. Both these concepts have been heavily criticised as being 'myths' or 'fetishes'. Indeed, Lynch [1979] asks that we 'examine the fetishism of academics and check what concrete social interests lie behind the use of these in the analysis'. We do not believe in the romantic picture of slums as being exotic in any sense, but at the same time, it is also not proper to hold that all slums arise out of acts of criminal, vagrant and anti-social elements. The hutment and pavement dwellers are also respectable citizens of India, who come to the city to earn their livelihood and contribute in a no mean way by their productive activities.

The word slum actually, is derived from 'slumber' and was originally used to refer to 'dark back alleys.. soot grimed... in disrepair', [see, e.g., Webster Dictionary, 1931: foul back street of a city... a low squalid neighbourhood). Also, originally, it referred exclusively to the physical fact rather than to the social dimension, with the consequent focus being on purely financial solutions. Operationally, slums can be grouped as (i) areas comprised of permanent and multi-storeyed buildings, which were constructed years ago, when the standards for living were much lower and principles of sanitation were different, (ii) properties or areas built with authorised but temporary or semi-permanent structures, whose deterioration is fast, (iii) areas with unauthorised or unsanitary dwellings, by vagrants or homeless [Bombay Municiple Corporation (B.M.C.), 1957]. Nowhere has the urban policy been more lacking than in the area of housing thanks largely to a policy imbued with 'lofty irrelevance'. The Task Force on Housing and Urban Development, set up by the Planning Commission has aptly pointed out, 'one of the key challenges for urban policy for the next couple of decades will be the search for means to provide adequate shelter to the poor. If it is not possible to provide anyone with housing of high standard, it should at least be possible to make provision of healthy environment in areas which are normally called slums' [1990].

India has upward of 75 per cent of its total population residing in rural areas and yet it has some of the largest cities in the world. The growth of metropolitan cities has been rather haphazard and unplanned. This can be seen from the fact that between a fourth and around a third of the total urban population lives in slums and squatter settlements [De Souza, 1983].

Mumbai: An Illustration

The island city of Mumbai and its extended suburbs form the Greater Mumbai city. On this narrow land mass of 603 square kilometers reside over 10 million people, supporting around 17,000 persons to a square kilometer. As the richest city in the country, and as the capital city of the most urban state in the country, it is staking claim to becoming a major international centre (especially financial) in a fast globalising economy. Yet, Mumbai truly is a city of contrasts, for, the city of 'global' pretensions also 'houses' more than half of its people in slums, and over 6 per cent go to bed hungry and has 0.3 per cent pavement dwellers. In spite of all this, migrants continue to come in - albeit at a slower pace - for, the income and expenditure levels in Mumbai are more than twice as much as in rural Maharashtra and the physical infrastructure though rapidly deteriorating, is still better than many a city in India.

Let us now turn to looking at some of the facts and features about the city of Mumbai. At the outset, we must mention that whereas the general features about Mumbai have been derived from various sources, we have made use of two important documents [Deshpande, S. and Deshpande, L. 1993 and Mujumdar, N. and Pethe, A. 1996] in getting the latest data on population, migration and slums. The Census of Mumbai enumerated 9.9 m. persons in the district of Greater Mumbai in 1991. According to this count, 1.7 m. persons were added in the preceding decade. The 1980s thus mark the watershed in the population history of Mumbai. During 1951-81, Mumbai's population grew at a compound rate of 3.4 per cent. In the 1980s, the growth was at 1.9 per cent showing a slower growth than both Maharashtra as well as India. Migration contributed barely 17 per cent as compared with 47 per cent in 1971-81. Indeed, migration's contribution has been continuously declining ever since 1951. Of course, both these figures are suspect according to Deshpandes. They cite alternative sources and methods to show that they reach a population figure of 10.5 m. with a contribution from migration at 39 per cent. They also opine that in the context of planning for infrastructural requirements of Mumbai city the undercounting may have been deliberately underbiased.

Continuing the past trend, the sex ratio of Greater Mumbai moved closer to equality from 1,296 males per 1,000 females in 1981 to 1,222 males in 1991, which clearly implies that the implicit (potential) need for residential dwelling must increase. Also, it shows that the earlier impression that males migrate to a city like Mumbai in search of livelihood, leaving behind the female folk may not be entirely true anymore.

Nowhere is the failure of urban planning more clearly discernible than in the area of housing, given that the slum and squatter colonies have mushroomed. Data given by the Census reports reveals that between 1961 and 1981, nearly 70 per cent of households in Mumbai, occupied a one room unit with 5 persons in each one of them. Whilst all kinds of material is used in the construction of these 'houses' leading to Census reporting them as structurally defective, the major problem is to do with other amenities such as drinking water, electricity and sanitation. The main problem in this case is of toilet facilities.

Slums have been rationalised as being necessary concomitants of industrial cities. The difference between formal housing provision and the resources set aside, when compared even with the severely underestimated official figures show that the crux lies elsewhere. There has been a severe under-investment in formal housing that the poor can afford, almost giving the impression that there is a tacit agreement amongst the rich and the middle-classes to share the civic amenities between them leaving the slum dwellers at the margin of periphery, to fend for themselves. The Census count in 1976 was 3.8 m. Making reasonable assumptions, Deshpandes predict the slum-dwellers to be around 6.8 mn. currently, which works to over 65 per cent of the total population. Thus, as per Census proportions of recognised slums, the lower limit of persons living in such areas may be estimated at 55 per cent. The most deprived people in Mumbai are of course, the homeless which are currently around 3,50,000. Not only this sector and other crucial infrastructural facilities required for supporting the system need tremendous amount of resources, also along with the financial resources another crucial input is the political will. It is strange that, Mumbai which occupies barely 0.02 per cent of the total land in the country, houses 1.2 per cent of its populace and 4.6 per cent of its urban populace and contributes around 3 per cent of the NNP, should face dearth of resources. Despite a lot of work being undertaken by Brihanmumbai Metropolitan Regional Development Authority (BMRDA) and Maharashtra Housing and Area Development Authority (MHADA), clearly much remains to be done and perhaps the solution should not sought within - the demonstrably non-viable - conventional framework. In passing, one may note that the problem here is also one of information. The present methodology for collecting data on informal sector capital formation (especially housing) is so full of lacunae that unless the municipal authorities are mandated to take up this issue, much of the discussion is likely to take place in near factual vacuum [see Mujumdar, N. and A. Pethe 1996]. In discussing the issue of the growth of Mumbai, there has been always the claim that it is terribly overcrowded with no place for more people. Of course, other studies have shown this to be quite untrue and have claimed that with proper policies, even with a low floor-space-index (FSI), it would be quite possible to accommodate twice the number as of now. One of the offshoots of the earlier argument was that (and this has grown more strident of late) migration to Mumbai should be stopped or at least controlled. It may be interesting to note that even in the seventies and eighties, the cities in general grew more by natural factors than in-migration. In the case of Mumbai the contribution of migration to population growth has been close to half. Unfortunately, most people tend to underplay, if not completely overlook the positive contribution of migration. It has to be noted that the poverty ratio in the city has tended to decrease even when the migration increased. The metros (like Mumbai) attract people who are quite skilled and indeed their incomes at home (native place) and Mumbai tend to stand in the ratio of 1:3. There is one discernible qualitative difference in the migrants. Earlier, they used to be predominantly male. Of late, the ratio is turning in favour of the females, i.e., there is evidence of family migration and it is noteworthy that this phenomenon is not limited to the poorest lot amongst the migrants. This is a vast intricate and interesting issue and in the later phase of this survey work will be gone into in greater detail. We now turn to a snapshot of a typical household in the slums of Mumbai.

A typical household in informal slum in Mumbai comprises (this is derived from a study by Mujumdar and Pethe, 1996) around four persons, with a chance of one or two of them being females. The sample households here are not particularly uneducated, compared to the rest of the city population. The income level is around 33,000 rupees per year and, typically, there would be a TV and a radio in the house. The size of the house is rather small, i.e., around 135 square feet, out of which a small area is kept aside for cooking and another small area is denoted as a bathroom. The WC is missing on the premises. The house costs around Rs. 50,000 to construct, and though the surroundings are dirty and unhealthy, at least there is a modicum of safety and some social life. There is electricity available, but the water connection is not as easily available, though water is, albeit with some effort. The (formal) financial sector, reformed/liberalised or otherwise does not form part of their operating parameters.

From the general income levels, it could be hazarded that instead of 'upward mobility', or poor classes moving upward, we are seeing here a process of slums becoming the semi-permanent habitat of the lower middle classes. Two things are obvious, one, that the slum dwellers are not transitory and are here to stay, because a metro with all the hardships represents a hope and the potentiality for future growth. Even such a potential growth environment is non-existent elsewhere. Second, that it is well known that the problem though enormous, has a solution; studies have shown that even with a low FSI it is possible to house 20 million people in Mumbai!. Thus, what is required is a combination of alternative technology, requisite resources and above all the political will to deliver.

Summing Up

Let us sum up the article by going over some of the salient features of India's urbanisation. To start with a well-worn cliché, 'India lives in her villages', it is no surprise then that there exist numerous misapprehensions and fears about urbanisation. For instance, the fear that India is overurbanised, is true, if at all only partially. India is less urbanised than is to be expected, if the experience of all the countries (developed and developing) is taken into account. It is more urban than may be forecast using data only of the poor countries [Mills and Becker 1986; Shukla, 1988] Shukla opines that, 'increasingly, high quality studies converge to estimate that factor productivity rises by 5 per cent with every doubling of the city, which is a dramatic finding and indeed calls into question all fears and policies to restrain the city size adopted in India and elsewhere'. Contrary to the general impression of 'explosion' there is no evidence to support it, except for the decade ending 1970, when urban population grew at a massive 3.9 per cent. This may be partly explained by refugees, partly definitionally and partly as being due to relocation/rezoning effort. The urban population in India grew at 3.1 per cent in 1981-91 and the total population grew at 2.1 per cent. There is a discernible deceleration in urban growth [Deshpande and Deshpande, 1993]. Further, there have been fears expressed by some experts, e.g., A. Kundu, that the class size I cities have been growing faster than the rest and consequently leading to structural distortion. It is true that the share of relevant proportion in total urban population has risen from 60.4 per cent in 1981 to 65.2 in 1991, but this can be easily rationalised. The economic progress must lead to an increase in share of city dwellers of modest size. Also, in many cities (e.g., Delhi) agglomeration has in fact slowed down. With the improvement in transport facilities, people who work in the city centres can well afford to stay away and commute to their work place, rather than migrate. This has led to a transformation in the city growth and its structure. This is generally true and is not peculiar to India. Fortunately, there is a positive feeling about the urbanisation trend (notwithstanding some negative aspects) amongst scholars and policy makers, thanks largely to the research of scholars like Vibhooti Shukla.

In the end, let us say a word about the book which triggered off this article. It is undoubtedly a positive and important contribution by a budding young economist of great achievement and promise who, alas, is no more. The science of urban studies in general, as also specifically for India, is yet to emerge in a fully mature form. The issues raised and discussed by Shukla will go a long way in contributing to furthering the science of Urbanisation. Of course, the book is not a comprehensive treatment. Indeed it cannot be, for this is but an unfinished work, so that issues of human settlements are completely ignored and those of informal sector treated only briefly. The treatment too - which is at times overly and unnecessarily technical - may not satisfy all. But to the extent it goes, it treads positively and none can deny that quite a few topics of importance are treated with rigour and sincerity rarely seen in this sphere of research, which all too often is overtaken by politics, sociology and, worse still, by ideological rhetoric.

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BOOK REVIEWS

Knorringa, Peter, *Economics of Collaboration: Indian Shoemakers between Market and Hierarchy* in the *Livelihood and Environment,* Series, 3, Sage Publications, New Delhi, 1996, Pp. Price: Rs 295/-.

This book is a third volume in the series *Livelihood and Environment,* a long-term research programme of the Faculty of Environmental Studies, University of Amsterdam, The Netherlands. This series, we learn from the foreword, is directed towards opportunities and constraints faced by groups of poor people in their pursuit of livelihood, within an international context. In this book, the focus is on economic relations between small-scale producers and traders of footwear in Agra, a well-known cluster of shoe production. The study of such clusters of small-scale manufacturers has attracted much international attention in recent years. The successful economic performance of industrial districts in Italy is an important reason. A wide variety of production units, traditional and modern, coexist in Agra with varying marketing channels, including the ancillaries of large national companies like Bata and Carona. Moreover, leather working is the traditional occupation of the largest Scheduled Caste group, the Chamars. In Agra, Jatavs, a subgroup of the Chamars predominate as footwear workers. For Agra-Jatavs footwear is not just a line of work but a way of life, which provides people with identity. The Chamars are the first ranking Scheduled Caste in Uttar Pradesh, as in several states, where they constitute 56.5 per cent of the total Scheduled Caste population [Waardenburg, 1988]. The author's choice of Agra footwear for a study in livelihood and environment is well justified.

Reportedly, the Abid Hussain Committee on small-scale sector reforms has recommended the concept of 'clusters' as solution to the problems of small-scale industry in India. Most existing studies focus on producer-producer relation in non-hierarchical clusters where equals compete or co-operate. Agra is an example of non-hierarchical cluster. There could be hierarchical clusters where a large firm farms out parts of the production to small enterprises and thus engineers a division of labour. The study is based on a extensive field work carried out during the winter of 1990-91 and the winter of 1992-93. A sub-sector approach enables the author to identify five types of small-scale manufacturing units in the Agra cluster, namely, home based units, small workshops, larger workshops, large enterprise groups and small-scale industry (SSI) units. Home based units are estimated to constitute 60 per cent of total units, 25 per cent of the labour force and had a physical output share of 20 per cent. At the other extreme, the modern organised units are estimated to constitute only 5 per cent of the units but have an employment share of 25 per cent and an output share of 40 per cent. The higher productivity of large units is mainly due to subcontracting of labour-intensive operations to the home based women workers.

The study deals with producer-trader relations from the producer's perspective. The content of producer-trader relations is a primary concern to rational small-scale producers for two reasons. First, they do not sell directly to consumers but through market intermediation of traders. Their prime and, perhaps, the only source of information on demand conditions in the market is the traders. Second, their chance of success depends on their ability to respond to the received information on changing demand conditions and the terms of sale/transaction that they are able to obtain.

The study rightly recognises in the beginning that the question of what products to be manufactured is decided by economic agents other than the small-scale producer in question. This is a decision controlled by the leading actors, in this case the marketing agent or the local representative of the leading actors like foreign buyers, government emporia, large domestic companies, in the marketing and production chain (Chapter-3). To study interaction between agents in such marketing and production chains the author develops an analytical framework in Chapter 4. This framework draws upon, among others, recent theoretical approaches to the basic question in industrial organisation economics of buy or make decision: why in some cases firms decide to buy the product(s) from small-scale manufacturers, while in other cases they decide to build their own manufacturing plants to produce the chosen product. The answer given by economist Ronald Coase and elaborated by Olivier Williamson, is that there are costs of transaction (Pp. 49-50). Transaction costs include search costs of finding information about prices and quality of products, writing and enforcement of contracts and the costs of monitoring performance. When transaction costs are high the firm will decide to produce the product in-house rather than purchasing it from the market. That is internalise an external transaction, making the activity a part of the hierarchy of the organisation. In this abstraction the relationship between leading actors and small producers is only one of arm's length. In reality we observe several intermediate cases between market and hierarchy like subcontracting, franchising and other types of collaboration between economic agents. How does one explain the existence of intermediate regimes between market and hierarchy in the real world? The author emphasises the limitations of transaction cost economics. The received transaction economics focuses on transaction rather than on economic relation. Transactions should be considered as being embedded in ongoing relations. And any economic action is always embedded in the prevailing institutional setting. Mainstream institutional economists tend to assume a particular institutional setting implicity instead of examining the actual impact of variations in institutions. Further, the received transaction economics does not give due weight to issues of collaboration and trust. Empirical experience shows that successful actors gain from selective collaboration. The success of clustering firms in Italy has been shown to depend on the resilience of the wider network in which it is embedded.

In this background, the author argues that durable professional collaboration can be a rational strategy for actors in the vertical production and marketing chain. Collaboration requires trust. Greater trust lowers the transaction costs because it lowers the perceived risk of becoming a victim of opportunistic behaviour. In brief, economic agents may choose different mixes of market, hierarchy and collaboration. In the light of the theoretical literature the author distinguishes between six types of transaction regimes to understand the producer-trader relationships. Depending on the institutional setting, actors are more likely to choose specific transaction regimes. The labels used for the six transaction regimes are meant to symboloise different types of bilateral producer-trader relations. They are direct control, clan, auction, industrial district, subcontracting and networks.

The author goes on to identify three main institutional peculiarities that affect the content of economic relations in Agra's footwear industry: instability of the industry due to demand as well as supply factors, a legal infrastructure which weakens contract enforcement and caste based identity clash. The first two factors stress the need for network relations to reduce transaction costs. But the third factor blocks any form of collaboration between artisans and traders. In Agra producer artisans belong to the Scheduled Caste of Jatavs and the traders are predominantly from the so-called forward caste background. Jatavs run home-based units, work in home based units or work as production workers in workshops or small-scale factories run by white-collar entrepreneurs. The relation between Jatav artisans and traders falls in the category of auction regime. Agra's manifestation of the auction regime is the central footwear market where a fierce price haggling takes place between artisan producers and traders. This is not just raw opportunism but also outright hostility, a reflection of caste based antagonism.

The author with admirable clarity shows a significant correlation between entrepreneurial identity, the sort of units they run, and the market channel they supply. Jatav artisans deal directly with commission agents. Small and larger workshops, owned by white-collar entrepreneurs, work on order for the larger wholesalers. Modern small-scale factories deal with purchasing officers of export trading firms or large Indian firms or directly with foreign buyers. The remaining small-scale factories operate as departments of one of the larger enterprise groups. The commission agents, wholesalers, purchasing officers of large Indian firms and foreign buyers are the leading actors in this characterisation of transaction regimes. They (leading actors) may choose a particular strategy in shaping the marketing and production chain they control (Chapter 3). Braodly two forms of strategies are distinguished. First is called the low road strategy in which the leading actors focus on minimising the labour cost, sell in low price segment of the product market, use low level technology and pursue a sweatshop organisational strategy. Employment conditions in sweatshop strategy are informal, insecure and low paid. Second is called the high road strategy in which the actors see labourers as an asset, use high level technology, sell in premium segments of the market and provide better employment conditions. They pursue what is labelled as premium-artisanal strategy. The roots of this typology are briefly discussed in Chapter 4.

Is premium-artisanal manufacturing feasible given the current state of footwear industry in Agra? The author answers in the affirmative and presents a carefully argued case in Chapter 7. Obviously, it is in the long run interest of the manufacturers to secure admittance to attractive marketing and production chains. The more difficult question is with respect to demand and competitiveness of Agra's footwear. Here, perhaps, one would like to see more evidence. The author argues that demand is growing for cheaper varieties of premium-artisanal shoes in world markets (presumably!). Another source of demand is the new premium domestic market. Agra's manufacturing sector with its abundant supply of skilled labour has a comparative advantage in supplying to niche markets in India and abroad.

What are the barriers to the envisaged transformation? Lack of professional collaboration between sellers and manufacturers. Premium markets are volatile and these demand high levels of flexibility, which cannot be attained without close collaboration between sellers and manufacturers and build-up of trust. It is important to notice that personal trust often based on caste in India is exclusive. What is essential is process trust. This brings us to the question of the role of the government. What forms of interventionist strategies help? The author is very cautious in answering this vexed question. He favours a supportive role for the government in the form of support to industry associations and skill upgradation programmes. However, he notes a more general condition for the success of the transition, that is, a broader policy attack to reduce the pressure of labour surplus on income earning opportunities of the workers. Finally, the author considers that the solution could emerge only from within the Agra footwear community itself.

Other studies of industrial clusters have also underlined the importance of trust and social-cultural networking for the success of small-scale units [Holmstorm, 1997]. What factors promote or hinder process trust in an industrial cluster is a significant area for further research. Limited evidence seems to suggest that it is necessary to provide some kind of initial push for consortia or similar forms of trade associations to work. Indiscriminate public provision of supporting services may be a waste of effort and public money. Selective and sub-sector specific interventions like public investment in training can have positive spill-overs.

This careful and well-organised study could serve as a model for aspiring Indian research students. The author's conceptualisation of transaction regimes is illuminating. Bargaining atmosphere and depth of transactions is well captured in the description presented, based on field notes. This study clearly demonstrates the insights that can be gained by studying economic relations in a production and marketing chain framework. A useful and highly relevant contribution to our understanding of problems of industrial restructuring in developing countries.

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K.V. Ramaswamy,
Indira Gandhi Institute
of Development Research,
Mumbai.

Maheshwari, Shriram, *The Census Administration under the Raj and After,* 1996, Concept Publishing Company, New Delhi, Pp. 227, Price Rs 300/-.

Introduction

Census is the most important source of data on population and their characteristics. Considerable efforts go into its operation - recruiting and training of about a million enumerators and supervisors, listing of every household in the country, organising the final count of a nearly one billion population, ascertaining the characteristics of every individual in the population, compiling and publishing of the data.

The Book Under Review

In his book, *The Census Administration Under the Raj and After,* Maheshwari seeks to give a historical account of this massive operation under foreign domination and after Independence. The blurb on the jacket makes a disputable claim that it is the first study of its kind. The Census organisation itself has brought out two publications [Srivastava, 1972; Census of India, 1971, 1973] which contain rich materials on the evolution of Indian Census. Ashish Bose [1973, Pp. 18-32] and later Asok Mitra [1977] have contributed scholarly articles on Indian Census in historical perspective, Curiously enough, the book does not refer to these landmark studies even once.

Evolution of Census Organisation

The book begins with an estimate of India's population at various points of time between 300 B.C. and A.D. 1800. Having conducted the census of England as far back as 1801, the British wanted to introduce Census in India too. It took them some time to plan and execute a full-fledged Census. In order to meet the exigencies of administration, a series of sporadic Censuses were, however, undertaken between 1822 and 1869 covering one province or another. Besides, estimates of population of individual cities were attempted as early as 1687. The 1857 uprising made the British sit up and a serious attempt was made to obtain the size of Indian population through actual head count. It turned out to be a long drawn operation stretching over a period of five years from 1867 and 1872. Yet the entire country could not be covered. The next Census taken in 1881 was synchronous and systematic and, therefore, is considered to be the first modern Census in India. Since then, India has an unbroken record of decadal Censuses. When the Second World War broke out, England abandoned its census slotted for 1941. Though India too got embroiled in the war effort, it did not give up the 1941 Census.

Keeping this as background, the second chapter gives valuable insights into the problem of census taking in India, a country of continental dimensions - populous, vast and diverse. The problem is compounded by low literacy of the masses. When the first Census was launched, people were apprehensive why the government wanted to collect all manner of data about each and every individual. Rumours spread like wild fire that the government required the information to levy new taxes, to conscript young men to army, to procure women for British soldiers or to force labour to migrate to overseas British colonies. The administration found it difficult to scotch such rumours.

The next three chapters are devoted to a discussion on Plowden Committees Report [1878] which drew a blue print for Indian Censuses, especially the first Census conducted in 1881. The Committee Report spelt out the *modus operandi* of the Census and the time limit for every operation such as house-listing and final counting of the individuals. It prescribed the questionnaire to be canvassed, the agency to be employed for enumeration work, the mode of compiling statistics and the printing of the necessary forms and reports. The Committee pleaded for a legislation to back up census work, to make the co-operation of each citizen mandatory and to ensure the confidentiality of the information provided by individual respondents. The committee felt that in a nation-wide Census, the number of questions seeking information on individual characteristics should be kept to the barest minimum in order that the bridge bore the traffic. While expatiating on the Committee report, the author reviews the Census methodology and procedures and the concepts behind them. For example, he discusses at length the appropriateness of synchronous (single day enumeration) versus non-synchronous (enumeration spread over a longer period of time) Census for a large country like India. He elaborates on *de facto* (counting of persons actually present in the place on the day of enumeration) and *de jure* (counting of persons normally residing in the place) approaches to Census enumeration.

The next two chapters address themselves to describing the administrative set up and organising the field work. The census work was conceived of as a periodic task and the organisation set out to accomplish the task was aptly described a phoenix arising out of its ashes every ten years to perform a country-wide operation and to die after its completion. Census organisation has always ridden piggy back on the normal administrative system. At the top level, some important changes have taken place though. The Census Commission has been made a permanent organisation. With the strengthening of vital statistics and social division, there is considerable expansion in the technical wing of the organisation. With the passage of the Registration of Births and Deaths Act in 1969, a post of Registrar General was created and merged with the post of Census Commissioner. The new functionary was redesignated as Registrar General and Census Commissioner and a senior level Indian Administrative Service (I.A.S.) Officer in the rank of Joint Secretary to the Government of India is appointed to the post on a regular basis.

At the grass roots level, the Census has remained much the same even today. The Census enumerators who work at grass roots are, by and large, drawn from primary school teachers and *patvaris* in rural areas and from clerks and other staff in government offices in urban areas. The job of the enumerator is to visit every household within the locality assigned to him and collect the required information. He is paid a small honorarium for this extra work. This has made the Indian Census one of the most economically run operation in the world. Indian Census, by any standard, is an extraordinarily large and complex undertaking. The author has been able to lay his hands on a variety of documents, but he has failed to organise them properly and present the facts cogently. Consequently, the reader of the book must strain himself rather too much to get at these facts.

Change of Thrust in the Area of Investigation

The rest of the book is concerned with shift in the focus of Census investigation. During the colonial era, the Census was pre-occupied with caste, tribe, religion and language related themes and a great deal of its energy was spent in collecting and analysing these data. The British wanted to understand the people they governed. The Census, no doubt, whetted their intellectual appetite. More than that, it provided them a powerful tool in their colonial administration. After the advent of Independence, the inadequacies of Census data for planning purpose was realised. The Census abandoned the earlier practice of cross tabulating all and sundry data by religion, caste or language. Instead economic orientation was given to Census.

The British administrators were not used to the institution of caste in their own country. They were fascinated by the phenomena of castes and sub-castes and sought to find some order in them. The Census came in handy to collect enormous amount of data on castes and to classify caste groups on status based hierarchy. It gave fillip to caste groups to form caste based associations calling themselves by new and high sounding Sanskrit names. These caste associations exerted pressure on the government and Census to give their caste a higher status than before in the caste hierarchy being evolved by the Census. It should therefore be amusing to the present observers of Indian society that the very same caste groups are vying with one another to get backward or most backward caste tags for themselves in order to get preferential treatment from government. The government of free India realised that collection of caste data would make people more and more caste conscious and decided to do away with the question on caste from the Census questionnaires. Except for Scheduled Castes and Scheduled Tribes, the Census has stopped collecting information on all the other castes from the first post-Independence Census of 1951 onwards. The exemption shown in the case of scheduled groups is due to the constitutional provisions which necessitate the monitoring of their socio-economic condition.

The British authorities sought to create a wedge between tribals and non-tribals by playing on religion. They generated a needless polemics whether those practising tribal religion be classified as Hindus or Animists. All important tables were cross-classified by religion till 1941. The post-Independence Census publishes only one table, giving just the distribution of population by different religions. The government's idea was that by withholding sensitive information on occupation and education by different religious groups, it can disarm those who are out to fan communal passion. It is pertinent to note that even the limited tabulation on religion has not precluded certain political parties from whipping up communal animosities by harping on the increasing proportion of certain minorities in total population.

The Census had from the very beginning profound interest in language. The language data were found to be very useful for drawing up of administrative boundaries and electoral constituencies and also to divide the people on the sly. A glaring example was the partition of Bengal and later annulment of the partition. The figures on the number of speakers of Hindi, Urdu, Punjabi and Maithili languages were often contested by Hindus, Muslims and Sikhs who were bent upon carving out separate territories for themselves.

With the ushering in of planned development in the country, the Census was called upon to provide more detailed information on the socio-economic and demographic characteristics of the people and also their geographic distribution. In response, the questions relevant for working population, migration were expanded to include new questions and sub-questions. The tabulation scheme has become more comprehensive and meaningful. The post-Independence Census adopted the international practice of collecting data on workers and giving distribution of workers by industrial and occupational categories. Another major contribution of the free India to Census was in the field of migration. The scope of migration has been enlarged in the schedule. It is now possible to identify rural to rural, rural to urban, urban to rural and urban to urban migration streams and to assess the motivating forces behind migration. A great deal of thought is now given to tabulation of data on urban places. This has resulted in a clearer picture of urbanisation process in India. The district Census handbooks added to Census publications provide valuable data even at village and urban-ward level and are a boon to micro-level planning. The technology of data processing too has changed from cumbersome slip counting to elegant and easy computer processing.

Concluding Remarks

The plus point that can be given in favour of the book is that it contains a number of excerpts from government dispatches and official letters in addition to copies of Plowden Committee Report and the Census Act of 1948. But these materials are mechanically reproduced and many a trivial information is repeated *ad nauseam* page after page. By meaningfully summarising the materials and subjecting them to rigorous analysis, in the light of changes taking place in Indian polity and society, the author could have enhanced the value of the book and made it more readable. At best, the book is a compendium of archival materials which are not easily accessible to uninitiated researchers.

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M. Johnson Samuel,
Associate Professor,
Institute for Social and Economic Change,
Bangalore.

Harshé Rajen, *Twentieth Century Imperialism: Shifting Contours and Changing Conceptions*, Sage Publications, New Delhi, 1997, Pp. 276, Price: Rs 350/- (Cloth), Rs 195/- (Paper).

An enduring concern of intellectual enquiry over the past two centuries has been the effort to explain and overcome the problem of inequality and exploitation in human society. Among scholars in the discipline of International Relations, only those of the Marxian persuasion (to whatever degree) make this their *problematique*. Rajen Harshé's *Twentieth-Century Imperialism*, firmly located within this paradigm,[1] treats imperialism as an integral manifestation of the global capitalist system and its agents (advanced capitalist states, multinational corporations). At its broadest, imperialism signifies 'an asymmetrical relationship of interdependence between materially advanced and backward societies' (p. 10). This may take the form of direct political control (colonisation) or economic and political structures of dominance (neocolonialism, dependency). In either case, advanced capitalism, which is the centre or core, is held to thrive on the extraction of surplus from the exploited periphery.

Despite the tendency in the West, especially the United States, to marginalise it, the Marxian paradigm has produced an abundant and rich body of work.[2] Much of this is on the phenomenon of imperialism. Harshé's work attempts to capture the diversity of this literature in order to present a critical and comprehensive picture of the complex manifestations of imperialism. As a concept, imperialism has a wide range of meanings, from 'folk' theories of biologically-driven or population-propelled aggression to Schumpeter's social-psychological theory of 'object-less expansion'. The author explicitly confines himself (Ch. 1) to Marxian conceptions of imperialism, but in his detailed analysis of the Soviet Union's imperialist tendencies (Ch. 5), admits that 'imperialism need not be confined to capitalism'. (p. 216). A brief consideration of the several meanings of the term 'imperialism' would not only have been useful in locating the concept, but would have made the author's own understanding of it clearer, since nowhere in the book is imperialism properly defined.

Harshé's work comes at a time when the Marxian enterprise is very much on the defensive. The Soviet Union is history, Eastern Europe has turned away from socialism, and China and Vietnam are experimenting with market economies. The 'Third World' is fast losing that nomenclature as it abandons its adversarial view of the developed countries and embraces capitalism with unprecedented enthusiasm. The term 'imperialism' is itself less and less frequently used in current political debate, even in critical analyses of capitalism. In this sense, the book is more a useful history than a reflection of current Marxian thought on the dynamics of capitalism. It, nevertheless, serves to familiarise the student with a balanced and critical analysis of the structural aspects of capitalism that facilitate - from the Marxian standpoint - processes of exploitation in the global economy. A brief summary of the book will be useful at this point.

Chapter 1 reviews radical expositions on imperialism, encompassing Lenin, Mao, Nkrumah and dependency theory. Drawing upon the works of Magdoff, Petras and Morley, the author stresses the importance of strategic factors in the expansion of the 'imperial state' (the United States). In Chapter 2, the post-colonial state is examined in the context of sub-Saharan Africa. While 'moderate' States like Nigeria and Kenya consciously retained links with their former colonial masters, 'radical' States such as Ghana, Tanzania and Angola engaged in a futile effort to stave off neocolonial dominance. Chapter 3 focuses on semiperipheral or 'intermediate' capitalist states. Harshé distinguishes among three subtypes within this category: sub-imperial states (Brazil, the Shah's Iran), which facilitate imperialist penetration while trying to preserve some space for domestic capital; the proto-second-tier imperial state (India), which is relatively autonomous and represents the horizontal expansion of capitalism into other developing countries; and the special case of apartheid South Africa, which combined 'internal colonialism' (white over non-white) with close links to Europe and North America.

Shifting from concrete economic and political structures to structures of legitimation, Chapter 4 focuses on the Gramscian concept of hegemony. Harshé reviews the analytic contributions of Robert Cox, Stephen Gill and others, and examines the operation of hegemony in the realm of values and understandings through the Trilateral Commission (representing the United States, Western Europe and Japan) and 'fraternal' organisations such as the Council on Foreign Relations and the Ford Foundation. Gramscian analysis, appreciated for its contribution to our understanding of the more subtle workings of imperialism, is faulted for its failure to grasp the complexities of the Third World and for its neglect of counter-hegemonic projects, such as those represented by the Non-Aligned Movement (NAM) and the Soviet Union. The latter is assessed in critical detail in Chapter 5. Was the

Soviet Union's project emancipatory and counter-hegemonic or, as the realist and Marxist critics charge, imperialism in socialist guise? Acknowledging the simultaneous existence of both tendencies, Harshé concludes that, on the weight of its relations with the Third World, the soviet project was more emancipatory than imperialist.

The last chapter is a broad review of sorts, touching lightly upon the US hegemonic decline, globalisation, the relevance of Marxism as a method of analysis, the complexity of the Third World societies, and the post-cold War weakening of NAM.

From the standpoint of those unfamiliar with the literature, the book provides a useful exposition of the Marxian perspective on post-colonial mechanisms of control which are held to facilitate exploitation. These encompass market domination through the overwhelming power of finance and technology; the core-semiperiphery-core chain; and the role of hegemony in facilitating the chain of exploitative relationships. Harshé's analysis, however, does not accept an overly simplified view of this chain: he argues that stronger Third World states do have degrees of autonomy and do not play a wholly subordinate role in relation to the capitalist centre. Nevertheless, the book reflects the ambivalence of Marxian analysis. On the one hand, there is a tendency to view capitalism as a unified and integrated force. This is particularly evident in the writings of world-system analysts and Nkrumah. On the other hand, the Marxian paradigm recognises capitalism's internal 'contradictions': rivalry among capitalist states, competition among firms, and differences of interest between capitalist states and multinational corporations (MNCs). Harshé's position is not clear, since he at times speaks of 'conjoint' control/management by capitalist states and MNCs (Pp. 52-3, 245), and elsewhere acknowledges that in the era of globalisation, financial markets are resistant to state control, while the links between capitalism and the state are being diluted by the 'increasingly stateless and nationless character of MNCs' (p. 246).

Where, then, is imperialism to be located? If capitalism is a highly disaggregated set of phenomena unified only by a broad 'mode of production' (whether in an industrial or post-industrial context), it must surely be more useful to think of diverse imperialism. But that pulls the rug out from under the Marxian paradigm, since it leaves us with a congeries of exploitations that can arguably be better accommodated by non-Marxian modes of analysis, such as the simpler power-based conceptions, central to the realist paradigm.

Harshé's neglect of the processes of globalisation, on which there is a growing body of writings over the past decade, is in large part responsible for his failure to tackle this problem squarely. A number of issues raised in the globalisation literature raise awkward questions for any thesis on imperialism. What are the implications of the emerging post-industrial economy based on information technology and global information flows? On the one hand, it is evident that monopolistic drives do exist (e.g., Microsoft's efforts to dominate the software market and the Internet). But not only are these being resisted by rival firms, it is far from clear whether the market itself is conducive to centre-periphery analysis. Firms going global today do not simply distribute a centrally-developed product in the periphery. Increasingly, they design and source products globally and adapt to local market demand in order to maximise sales in a highly competitive system. As in the case of manufactured products, this applies to information technology products ranging from financial consultancy packages to television programmes. In this context, it is not at all clear to what extent information flows can be controlled from a 'centre'. A relatively neglected aspect of academic theorising on globalisation is the way in which individuals everywhere are upgrading their personal skills and challenging power and authority structures in every kind of society and at every level [Rosenau, 1990]. Whether any theory of imperialism, which must ultimately rest on the power and authority of one or more imperial centres, can stand up to these phenomena is doubtful.

The global capitalist economy today is characterised by high-velocity financial flows. The major portion of these flows is in the form of fast-moving currency trading and short-term investment by large, professionally-managed institutions such as pension funds. These can have highly destabilising effects on stock and money markets (the Crash of 1987 on the New York Stock Exchange, the 1997 Thai crisis). Can pension funds and the like be endowed with 'imperialist' characteristics?

The Marxian approach has also been internally divided on the question of the 'progressive' aspects of capitalism/imperialism. Marx himself viewed the spread of capitalism in a positive light because it helped destroy pre-capitalist social structures and was, from this perspective, in tune with his conception of historical advance. Lenin was aware of both the generative and repressive aspects of imperialist expansion. With some exceptions, the Marxian paradigm has tended to stress the latter, Harshé, too, leans toward this view. The historical evidence is far from clear. On the one hand, there is the evident failure of many developing countries to achieve their potential, which the radical critics reviewed in Chapter 1 put down to the structural constraints imposed by imperialism. On the other hand, there is evidence a plenty of 'periphery' states undergoing a successful transition to the centre, e.g., the United States (once a dependency of Britain) and, more recently, South Korea and Taiwan.

Both the Marxian approaches tend to neglect the importance of domestic arrangements that affect the capacities of particular societies to undertake the transition from periphery to centre.[3] Aside from focusing on the collaborative role of developing-country elites in facilitating the exploitation of their own masses, these approaches apportion little space for an analysis of the nature of social and political organisation in developing countries or the kinds of growth strategies adopted by them. Inevitably, their understanding of the problems experienced by these societies is limited. Harshé's own understanding is more sophisticated, for, he argues that developing-country elites do have concerns and interests that do not reflect those of the capitalist centre(s) (e.g., in Brazil and India), and that developing societies are complex entities that resist standard Western categories like 'class'. However, he does not explore these domestic complexities or their implications for a potential transition to real economic growth.[4] An exposition on imperialism that does not give adequate consideration to the role of domestic factors in either generating or inhibiting economic growth can only present a limited picture of the reality. The Marxian paradigm as a whole is vulnerable to this criticism.

Ultimately the ability of not a few states to undertake the transition from periphery/semi-periphery to centre challenges the very basis of the dominant Marxian view of imperialism. This fundamental weakness, combined with the collapse of orthodox socialism and of developing-country hostility to capitalism, has had a significant impact on Marxian thought. Still reflecting Marx's basic concern with regard to alienation, recent Marxian writing has shifted away from conceptions of imperialism and dependency to a broader enquiry into estrangement between all sorts of human groups, including those based on gender, language and religion. This marks a revival of the cultural themes stressed by the early-twentieth century Austo-Marxists and a retreat from the universalising tendencies of Marxian thought in the face of post-modern critiques [Linklater, 1996]

If imperialism as a concept is hard to sustain, what might be said of counter hegemonic projects? The Soviet Union's ambivalent and ultimately unsuccessful role in this regard is recorded by Harshé, as is the failed effort of developing countries to restructure centre-periphery relations. Uncertainty over what exactly constitutes imperialism today perhaps leads him to conclude with the vague hope that the Third World's 'responses to imperialism are likely to crystalize through fresh emancipatory ventures launched under the banner of broad movements like the NAM' (p. 257). The author might usefully have considered other possibilities. China, on which he scarcely dwells, might be seen as a counter-hegemonic project in spite of its having embraced 'market socialism', if such a project is viewed in political terms. What the Chinese seek to counter is not capitalism itself, but its political form. The same might be said of the weak but continuing efforts of the developing countries through the

Group of 15 (G-15) or NAM to shape the terms of their integration into the global economy. In the long run, it is not inevitable that capitalism will sustain its present form of increasingly uncontrolled growth accompanied by the dismantling of state-established welfarist structures. There are challenges not only from developing societies, but also from within in the form of a range of humanist emancipatory movements (based on issues such as gender and ecology) that seek to modify capitalist society.

Notwithstanding left-wing scholarship's growing shift away from theories of imperialism and dependency [See, e.g., Paul, 1997, Pp. 205-26], the concerns of the imperialism thesis still remain valid. Inequality, alienation, marginalisation and the rising tide of materialism/consumerism are problems central to an age in which capitalism appears to have triumphed in the putative 'end of history'. The simultaneous expansion of the global capitalist economy and the empowerment of ordinary people means continuing tension between economic power and the needs of the poor and the marginalised. Fundamental shifts in technology and economic organisation have in the past augured eras of turbulence. Current debates on the direction of 'post-Fordist' society and on the potentialities of civilisational conflict are awkward, groping efforts to peer into an uncertain tomorrow. In this respect, Harshé's work seems dated. For those seeking to grapple with the future, it will be necessary to start where the *Twentieth-Century Imperialism* stops.

NOTES

1. For a discussion on paradigms, including the Marxian paradigm, see Holsti, 1985.
2. For useful reviews see Thorndike, 1978.
3. Liberal theorists, by ignoring external structural obstacles to growth and emphasising internal distortions, do the reverse.
4. For useful analyses focusing on domestic constraints see Gros, 1996 Pp. 455-71 and Lewis, 1996, Pp. 92-129. For a balanced view of the success stories of four Asian Tigers, see Harris, 1996.

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Rajesh M. Basrur,
Reader in International Law,
Department of Civic and Politics,
University of Mumbai,
Mumbai.

Dubhashi, P.R. *Economic Thought of the Twentieth Century and other Essays,* Concept Publishing Company, New Delhi, 1995, Pp. 277, Price Rs 400/-.

Dubhashi is wellknown as a reputed civil servant trained in economics and an earnest and articulate intellectual. This book is a collection of his writings, addresses and reviews during the last three decades. They range over economic thought, development planning, poverty, environment, and world economic order. This a useful collection of writings and is welcome.

In reading these, one has a sense of *deja vous.* They are responses to problems and situations as they arose during the course of Indian development over the last thirty years. As is to be expected in these writings on overlapping subjects there is a degree of repetition in them. Though they are critical and honest they do not throw up any striking insights into the inwardness of the events of that period.

There are a few instances of this information. An example is the author's observation on p. 91: 'The most outstanding example of populism intruding into the orderly process of planning was the introduction of the 20-point programme by Indira Gandhi. Professor D.R. Gadgil, the then Deputy Chairman of the Planning Commission who felt uneasy about it, had to go'. This was not so. Gadgil was not Mrs. Gandhi's choice for heading the Planning Commission. He had been thrust upon her because of her initially weak political strength. As soon as she gained strength after the 1972 elections she got rid of him and the other members of the Planning Commission, and fashioned it according to her heart's desire. The 20-point programme had nothing to do with it. But such instances are few and far between. Nevertheless, these thoughtful musings are instructive and interesting.

N.V. Sovani,
Former Professor,
Gokhale Institute of Politics and Economics,
Pune.

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Chakravarty, S. 1987; *Development Planning: The Indian Experience*, Clarendon Press, Oxford.

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4. For a critique of recent industrial policy proposals, see Marshall [Marshall, 1983, Pp. 281-98].

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