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AN INTRODUCTION
TO THE STUDY OF
INDIAN ECONOMICS.
Vol. II

BY THE SAME AUTHOR.

- 1** INDIAN ADMINISTRATION
- 2** GOKHALE AND ECONOMIC REFORMS
- 3** INDIA'S WAR FINANCE AND POST-WAR PROBLEMS
- 4** CURRENCY REFORM IN INDIA
- 5** INDIAN INDUSTRIAL AND ECONOMIC PROBLEMS
- 6** THE REFORMS EXPLAINED
- 7** THE DAWN OF MODERN FINANCE IN INDIA
- 8** ECONOMICS OF PROTECTION IN INDIA
- 9** ECONOMICS IN INDIA

AN
INTRODUCTION
TO THE STUDY OF
INDIAN ECONOMICS
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Vol. II

BY
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PREFACE

The first Volume of this work was ready, printed, by the end of March, and this, the second Volume, is out of the press to-day, the 30th June, 1930. The two Volumes are being issued together. Advantage has been taken of the above interval to introduce into the second Volume the latest facts and figures relating to the trade, currency, banking and finances of India; and even a summary of Mr. W. T. Layton's recommendations relating to the reorganization of Indian finance on a federal basis, has been given in Appendix II at the close of the second Volume. Though both the size and the bulk of the work have been increased, the old price, Rs. 10 for the two Volumes, has been retained for the benefit of the student world in India.

Durgādhivāsa, Poona 4 }
30th June, 1930. }

V. G. KALE.

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APPENDIX I

We give below a few statements of the latest available statistics relating to the position of prices, currency circulation, foreign trade and the Imperial Bank of India. It will be seen from them how the tendencies with respect to economic depression, currency deflation and falling prices, which have been discussed in this Volume, are still in operation:—

(A)

Comparative Prices

| | INDEX NUMBERS. | | | | | |
|----------------|-------------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| | Wholesale Prices. | | | Cost of Living. | | |
| | April 1925. | End of 1928. | End of 1929. | April 1925. | End of 1928. | End of 1929. |
| Great Britain | 161.9 | 137.6 | 125.4 | 173.0 | 165.0 | 164.0 |
| U. S. A. | 144.6 | 140.9 | 125.0 | 158.0 | 157.0 | 157.0 |
| Canada | 162.0 | 147.7 | 150.2 | 152.0 | 151.0 | 154.0 |
| Belgium | ... | 125.0 | 116.6 | ... | 216.0 | 228.0 |
| France | ... | 128.0 | 114.1 | ... | 113.0 | 115.0 |
| Germany | 141.0 | 138.9 | 132.3 | 136.0 | 153.1 | 151.6 |
| Italy | ... | 125.8 | 113.9 | ... | 148.0 | 150.0 |
| Japan | 204.0 | 172.2 | 154.9 | 241.0 | 208.0 | 194.0 |
| India (Bombay) | 165.0 | 147.0 | 141.0 | 158.0 | 148.0 | 150.0 |

| | PERCENTAGE CHANGES. | | | |
|----------------|---------------------------|--------------------|-----------------------------|--------------------|
| | Apr. 1925 to End of 1929. | | End of 1928 to End of 1929. | |
| | Wholesale Prices. | Cost of Living. | Wholesale Prices. | Cost of Living. |
| Great Britain | —22.5 p. c. | — 5.2 p. c. | — 8.9 p. c. | —0.5 p. c. |
| U. S. A. | —13.5 " | — 0.6 " | —11.3 " | ... |
| Canada | — 7.2 " | + 1.3 " | + 1.7 " | + 2.0 p. c. |
| Belgium | ... | ... | — 6.7 " | + 5.6 " |
| France | ... | ... | —10.9 " | + 1.9 " |
| Germany | — 6.1 p. c. | +11.5 p. c. | — 4.7 " | —1.0 " |
| Italy | ... | ... | — 9.4 " | + 1.4 " |
| Japan | —24.0 p. c. | —19.5 p. c. | —10.0 " | —6.7 " |
| India (Bombay) | —14.5 " | — 5.1 " | — 4.1 " | + 1.3 " |

(B)

Foreign Trade of British India.

1929-1930

| | (In lacs of rupees.) | + Signifies net exports, — " " imports. | |
|--|----------------------|--|------------------------------|
| | | 1st April | 1st April |
| | | 1929 to 31st March, 1930. | 1928 to 31st March, 1929. |
| Imports of merchandise ... | | 2,40,76 | 2,53,31 |
| Exports including re-exports of merchandise ... | | 3,17,93 | 3,37,96 |
| Net imports of Gold ... | | 14,22 | 21,20 |
| Net imports of Silver ... | | 11,89 | 13,04 |
| Total visible balance of made ... | | + 52,82 | + 52,11 |
| Net balance of remittances of funds. ... | | -21,01 | -41,39 |

(C)

Paper Currency Returns.

(In lacs of Rupees.)

| | 22nd May 1930. | 22nd Apr. 1930. | 22nd May 1929. | 22nd Apr. 1929. |
|---|-------------------|--------------------|-------------------|--------------------|
| | Rs. | Rs. | Rs. | Rs. |
| Notes in circulation ... | 1,70,64.9 | 1,73,32.3 | 1,83,04.4 | 1,84,71.7 |
| Reserve-Coin and bullion in India— | | | | |
| Silver coin ... | 1,07,05.4 | 1,06,64.4 | 94,28.4 | 94,77.2 |
| Gold coin and bullion. | 32,27.6 | 32,27.4 | 32,21.6 | 32,21.6 |
| Silver bullion under coinage ... | 3,37.3 | 33,8.3 | 4,33.5 | 4,67.0 |
| In England— | | | | |
| Gold coin and bullion. | ... | ... | ... | ... |
| Silver bullion ... | ... | ... | ... | ... |
| In His Majesty's Domin.— | | | | |
| Gold coin and bullion ... | ... | ... | ... | ... |
| In transit between India, England and His Majesty's Dominions— | | | | |
| Gold coin and bullion ... | ... | ... | ... | ... |
| Silver bullion ... | ... | ... | ... | ... |
| Total bullion and coin ... | 1,42,70.3 | 1,42,30.1 | 1,30,83.5 | 1,31,65.8 |

APPENDIX I

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| | 22nd May 1930. Rs. | 22nd Apr. 1930. Rs. | 22nd May 1929 Rs. | 22nd Apr. 1929. Rs. |
|--|--------------------------|---------------------------|-------------------------|---------------------------|
| Securities (purchase price)— | | | | |
| In India ... | 27,50.2 | 30,72.4 | 43,22.8 | 43,22.8 |
| In England ... | 44.4 | 29.8 | 8,98.1 | 8,83.1 |
| Total Securities ... | 27,94.6 | 31,02.2 | 52,20.9 | 52,05.9 |
| Grand Total of Reserve ... | 1,70,64.9 | 1,73,31.3 | -1,83,04.4 | 1,83,71.7 |
| Internal Bills of Exchange held on account of Government under Section 20 of the Indian Paper Currency Act, 1923 ... | ... | ... | ... | 1,00.0 |
| Percentage of Metallic Reserve to notes in circulation ... | 83.62 | 82.10 | 71.48 | 71.66 |

(D)

Imperial Bank of India.

(In lacs of Rupees.)

| | 23rd May 1930. Rs. | 18th Apr. 1930. Rs. | 24th May 1929. Rs. | 19th Apr. 1929. Rs. |
|---|--------------------------|---------------------------|--------------------------|---------------------------|
| Liabilities :— | | | | |
| Subscribed Capital ... | 1,125.0 | 1,125.0 | 1,125.0 | 1,125.0 |
| Capital paid up ... | 562.5 | 562.5 | 562.5 | 562.5 |
| Reserve ... | 532.5 | 532.5 | 522.5 | 522.5 |
| Public Deposits ... | 1,661.9 | 1,529.4 | 657.0 | 680.3 |
| Other Deposits ... | 6,825.4 | 6,899.3 | 7,261.3 | 7,433.4 |
| Loans against securities per contra ... | 166.7 | 166.7 | ... | ... |
| Loans from the Government of India under section 20 of the Paper Currency Act, against Inland Bills discounted and purchased per contra ... | ... | ... | ... | 200.0 |
| Contingent liabilities ... | ... | ... | ... | ... |
| Sundries ... | 164.0 | 140.8 | 150.3 | 102.3 |
| Total ... | 9,913.0 | 9,831.2 | 9,153.6 | 9,501.0 |

| | 23rd May 1930. Rs. | 18th Apr. 1930. Rs. | 24th May 1929. Rs. | 19th Apr. 1929. Rs. |
|---|--------------------------|---------------------------|--------------------------|---------------------------|
| Assets:— | | | | |
| Government securities ... | 2,671.4 | 2,702.7 | 2,104.7 | 1,908.5 |
| Other authorized securities under the Act ... | 283.2 | 283.5 | 253.0 | 238.6 |
| Ways & Means Advances to the Govt. of India ... | ... | ... | ... | ... |
| Loans ... | 1,388.5 | 1,400.3 | 1,097.9 | 1,804.2 |
| Cash Credits ... | 3,230.6 | 3,244.5 | 2,945.1 | 2,890.0 |
| Inland bills discounted and purchased | 458.2 | 577.1 | 716.1 | 1,045.7 |
| Foreign bills discounted and purchased | 51.8 | 47.6 | 33.8 | 47.8 |
| Bullion ... | ... | ... | ... | ... |
| Dead Stock ... | 282.2 | 281.2 | 285.4 | 283.9 |
| Liability of constituents for Contingent liabilities per contra | ... | ... | ... | ... |
| Sundries ... | 80.3 | 60.8 | 68.6 | 50.9 |
| Balance with other Banks | 37.9 | 31.7 | 24.3 | 37.8 |
| Cash ... | 1,428.9 | 1,201.8 | 1,624.7 | 1,193.6 |
| Total ... | 9,913.3 | 9,831.2 | 9,153.6 | 9,501.3 |
| Percentage Bank Rate ... | 16.20 6 p. c. | 13.75 6 p. c. | 20.13 6 p. c. | 14.18 7 p. c. |

APPENDIX II

STATUTORY COMMISSION AND FINANCE.

Federal and Provincial Finance

It will be interesting to notice that the chief points we urged in our discussion of the reform of the system of finance and taxation in the 18th and the 19th Chapters of this Volume, viz (1) that the system should be federal in character, (2) that the share of the Indian States in the burdens it imposed, should be duly recognized, (3) that a complete separation of the resources of the national and Provincial governments is not essential and (4) that the income tax should be a divided source of revenue, larger agricultural incomes being included in the amounts to be assessed, have been endorsed by Mr. W. T. Layton, the expert adviser of the Statutory Commission. The latter has, however, suggested that the Indian States claim, that they should receive a share in the customs revenue, will have to be set off by a similar counter-claim that they must bear a part of the increasing cost of Imperial burdens. The Butler Committee, therefore, proposed the appointment of an expert body to enquire into both claim and counter claim. Mr. Layton observes:—"But whatever the decision may be as regards the past, the development of India's finance in accordance with the plan outlined in this report will make the Central government increasingly dependent on customs revenue and increase the taxation which it imposes on the population of the states at a time when the cost of the Imperial burden is stationary or falling. It will, thus, strengthen the case for determining what is the burden that may in equity be imposed upon the states. Further, if uniform national excises are to play an increasing role in Indian finances, they will, if levied at the point of production, constitute a new form of taxation on the population of the states and make it still more important to find a means of harmonising the financial policy of the Indian states and of British India."

"This matter is, moreover, not merely one of financial adjustment, but gives rise to a claim that the representatives of the Indian states should be consulted on financial policy. The financial problem illustrates the need for the progressive development of the machinery of consultation between British India and the states, which the commission have proposed."

Mr. Layton's report is based on two general assumptions, firstly that it is both possible and desirable to improve the economic and social condition of India by a substantial increase in expenditure on the nation-building services, and secondly, that it is possible to raise additional revenues for this purpose provided that incidence of further taxation is adjusted to the capacity of the taxpayers to pay. If additional taxation is to be raised it is necessary that the new constitution should ensure

(a) that sources of revenue appropriate to their requirements are available for those authorities who have urgent and expanding services to administer.

(b) that all parts of India make a not unfair contribution to the common purpose.

(c) that the responsibility for imposing additional taxation is definitely laid upon those who will have to incur additional expenditure.

The existing financial scheme does not adequately fulfil those conditions especially as Provinces with rapidly expanding needs have sources of

revenue which are almost stationary. Provinces are treated unequally and industrial provinces have no power to tax industries. Analysing the elements that compose the Central Budget, Mr. Layton says that a surplus is likely to emerge gradually as a result of the growth of revenue, the chief contributor to which will be Customs. The surplus will not, however, be realised if the expansion of trade is checked by internal disorder or external difficulties or if India adopts a policy of extreme protection. Any prospective surplus in the Central Budget will go a comparatively little way towards meeting the needs of the Provinces. It is, therefore, essential to find new sources of revenue. Four sources are mentioned :—(1) increased yield of income-tax by lowering exemption limits, by steepening graduation in the case of intermediate incomes and by taxation of income invested abroad ; (2) abolition of exemption of agricultural incomes from income-tax ; (3) national excises on such commodities as cigarettes and matches ; and lastly, (4) Terminal taxes. Item (4) is a form of taxation which falls naturally within the provincial sphere ; but the others are taxes which should be the subject of central legislation and should be centrally collected.

“ Three methods of dealing with this situation have been suggested :—

(a) the assignment of all revenues (including customs &c.) to the provinces where they are collected and the financing of the central government by means of appropriate contributions from each province ;

(b) the transfer to the centre of certain services now performed by the provincial governments, or while leaving administration in the hands of the provincial governments, the financing of them from central funds by means of a system of grants-in-aid or by some other method ;

(c) the supplementing of the sources of revenue assigned to and collected by the provinces by certain national taxes collected by the centre on behalf of the provinces and distributed to them on some predetermined automatic basis.”

The first method was rejected as it was open to certain practical and theoretical objections. It would set up internal barriers and involve varying rates of duties which can most conveniently be collected by a central authority. The plan would, again, confer on the central government the right to interfere and to compel a defaulting province to produce its contribution. And lastly, the scheme is based on the indefensible assumption that each province has a natural right to all the revenue collected within it.

Though the second method is less objectionable and more practicable, it implies central inspection and at least a limited control over local activity. When nation-building services develop on a large scale, it will require a vast bureaucracy to administer them from a single centre or even to exercise financial control. Considering the size of India and its inherent diversity, centralization of such activities, is not a practical, even if it were desirable, policy.

The third method alone, therefore, remains. For reasons given, distribution to the province of origin, does not entirely meet the necessities of the case. Of alternative methods, the only one which is at once simple, automatic and to some extent a test of “ needs,” is distribution in proportion to population. To distribute a large part of the revenues of India on this basis would be unfair to the provinces with a sparse population and would tend to hold back the progress of the more advanced, and by transferring resources from the richer to the poorer provinces would divorce responsibility for taxation from responsibility for spending. But though for these

reasons the method can only be used to a limited extent the haphazard character of the provinces of India and the inequalities resulting from historical accident make it necessary to introduce into the financial system of India some device that will tend to mitigate the inequalities that at present exist.

A complete scheme of allocation should, therefore, provide for the distribution of centrally collected revenues in part according to origin and in part on a population basis.

The scheme proposed for the raising and allocation of resources in accordance with these principles will be as follows:—(i) For administrative and fiscal reasons customs duty on imported liquor should be brought into relation with the excise policy of each province, since the present arrangements under which customs duties are central while provincial governments control the possession transport, purchase and sale of such liquor, have led to considerable administrative friction. The duty on imported liquor should be reduced to the standard luxury rate of thirty per cent, and the provinces should be given the right of imposing further duties in the form of excises on such liquors in accordance with their excise policy. This would involve a loss of 1½ crores to central revenues. (ii) Revenue from commercial stamps should be transferred to the Centre. (iii) To meet the claims of the industrial provinces, one-half of the proceeds of income-tax should be assigned to the Province concerned. Super-tax would, however, continue to be entirely central since the central government, can not, at present, bear the loss which a division of this tax would involve. This will give the provinces 4½ crores a year. (iv) To enable provinces to adjust taxation between rural and urban classes, provinces may levy a surcharge on income tax collected on the incomes of their residents, the surcharge being limited to half the tax transferred to them. (v) Exemption from income tax on agricultural incomes should be abolished by definite stages and the whole yield of this taxation should be assigned to the province of origin. (vi) Provinces should be empowered to levy terminal taxes. (vii) There should be constituted a Provincial Fund fed by specially designated taxes including (a) excise on cigarettes, (b) excise on matches and (c) duty on salt (to be transferred when the Central Budget situation permits). The resources of this fund should be automatically distributed to the provinces on a *per capita* basis. A time-table should be drawn up under which each of the above items would be transferred according to a definite schedule that would complete the transfer in ten years. Here the urgent needs of Bengal, and to a less extent of Bombay, should be recognized and the transfer of income-tax receipts should be begun as early as possible. If all the proposals embodied in the scheme are carried out, the effect would be to add nearly forty crores to the Revenue of the provinces by 1940 of which twelve crores would have been transferred from the Central Budget. The proposal to assist the Provinces by means of the Provincial Fund is described as essentially a federal idea, and the importance of finding means of harmonising the financial policy of the States and of British India is emphasised.

It should be noted that consistently with the proposal of the Commission as regards constitutional development, the above financial scheme excludes Burma from its operation. Economically and nationally speaking, this is an undesirable and retrograde step.

Instead of dividing the revenues of India, as at present, into two sharply defined classes, Mr. Layton considers them under four heads, viz.

- (a) Revenue collected and spent by the central government ;
 (b) Revenue collected and spent by provincial governments ;
 (c) Revenue collected by the central government and distributed to the provinces according to the province of origin ;
 (d) Revenue collected by the central government and distributed to the provinces on the basis of population.

He expects that the revenues of British India, excluding Burma, as regards the first of the above categories, will show a surplus. Customs will grow by $\frac{2}{3}$ crore a year to $7\frac{1}{2}$ crores at the end of the decade. Income tax will rise by at least 4 crores. Army expenditure should drop to 52 crores (49 crores excluding Burma) in 1933. But an equal amount of 3 crores will have to be added to the civil expenditure of the central government (now 15 crores). Army expenditure should be reduced to 48 crores in 1940, of which 3 crores may be chargeable to Burma. Little increase is expected from Railway receipts, as their growth will be offset by the charge of redemption of debt.

It thus appears that there will be a surplus of $16\frac{1}{2}$ crores at the end of ten years on the existing basis of taxation. A substantial allocation of revenues to the provinces will thereby be rendered possible.

The situation of the provinces as a whole (excluding Burma) at the end of ten years under the new proposed scheme and on the basis of the assumed yield of taxes, will be as follows :—

| | | | crores |
|---|-----|-------|---------|
| Present Revenue (1929-30 Budget) | ... | ... | 78 |
| <i>Group (b)</i> | | | |
| Surcharge on personal Income tax | ... | ... | 3 |
| Terminal Taxes | ... | ... | (say) 8 |
| <i>Group (c)</i> | | | |
| Half of personal income tax transferred from the centre | ... | ... | 6 |
| Agricultural Income Tax | ... | ... | 5 |
| <i>Group (d)</i> | | | |
| Provincial Fund | ... | ... | 14 |
| | | Total | 114 |

The Central Budget at the end of the decade after the proposed allocations have been made, would be as follows :—

(In crores of rupees)

| <i>Revenue</i> | <i>Expenditure.</i> |
|--|---|
| Customs (after allowing for loss of portion of liquor duties) ... 54 | Defence (reduced by 7 crores and 3 transferred to Burma) ... 45 |
| Income Tax 20 | Debt ... 10 |
| Less allocated to provinces 6... 14 | Civil Administration ... 13 |
| Commercial Stamps ... 2 | Cost of Collection ... 3 |
| Salt (transferred) Nil | Civil Works ... $2\frac{1}{2}$ |
| Opium Nil | Other (including pensions) ... $3\frac{1}{2}$ |
| Railways 9 | Surplus ... $4\frac{1}{2}$ |
| Less additional sinking fund and interest charges 3... 6 | |
| Miscellaneous ... $5\frac{1}{2}$ | Total ... $81\frac{1}{2}$ |
| Total $81\frac{1}{2}$ | |

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