

THE FINANCIAL PROPOSALS IN THE SIMON REPORT

In the Montagu-Chelmsford Report of 1918, the subject of Finance received a very perfunctory treatment. In a volume of 282 pages, it was allotted 13 pages, not in a special chapter, but interspersed here and there. The Simon Report gives it the importance that it deserves. The Commission felt it necessary to secure the opinion of an economic and financial expert, *viz.*, Mr. (now Sir) Walter Layton, and in fact did little else than endorsing the latter's proposals. Mr. Layton shows an unusually brilliant grasp of the problems in Indian Finance. Let me say that at the very outset, because this article is going mainly to be a criticism of his views and proposals.

Mr. Layton starts very well by noting "three of the chief features of the financial situation in India, *viz.*, the mass of the people are extremely poor. She is incurring expenditure on the primary functions of Government, such as defence and the maintenance of law and order, as high in proportion to her wealth as Western nations. Her expenditure on social services such as education, health, sanitation, etc., on the other hand, is far behind Western standards, and indeed in many directions is almost non-existent."

There is one other 'chief feature,' *viz.*, that the expenditure on the superior administrative services in all departments is also on the Western standard as the recruitment for the same has been till recently almost exclusively from among the Westerners. Mr. Layton is, curiously enough, unaware of the fact that in specifying the three chief features he has constructed a syllogism wherein from the first two premises the conclusion in the third proposition naturally follows. In other words, it is because the people are extremely poor and the expenditure on

primary functions is high, that the same on social services is low or non-existent. Mr. Layton knows that "neither elected representatives nor the Government are willing to go very far in the matter" of increasing taxation. But he thinks that if increased taxation was earmarked for social services, it could be levied without becoming unbearable. He does not, however, stop to ask himself why, if that was so, Government in the six pre-Reform decades, when it had full powers of trusteeship, had been unable to follow that sage principle. So far as the people and their elected representatives are concerned, the question is not of what is to be done with additional money if raised by further taxation, but firstly as to whether additional taxation is necessary, whether the money that is raised by existing taxation is being properly expended, or a re-distribution of the same could make more available for the social services. Mr. Layton is aware of this, but he says, "It is outside the scope of my report to express an opinion upon either the efficiency and economy of the administration in India generally, or the large questions of policy involved in considering the scale of existing expenditure on defence or other purposes—though the analysis which follows may throw some light on the financial aspect of this latter problem." So this fundamental issues are outside the scope of Mr. Layton's inquiry. As regards the Simon Commission who may be expected to have considered those issues before endorsing Mr. Layton's proposals, they have nothing to say about the economy of administration in India, and as for the expenditure on defence they only look forward to "an equitable adjustment of the burden of finance" in the form of a non-votable contribution of an annual sum from Indian revenues.

Mr. Layton must be complemented for having ventured to go outside the scope of his enquiry to discuss the Indian expenditure on defence. He has no difficulty in showing that it is "not only high in itself and as compared with other countries, but it has also greatly increased as compared with the pre-war

situation." And the pre-war situation was such that Indian public men like the late Mr. Gokhale had for years been attacking our military expenditure as excessive and as a stumbling block in the way of greater expenditure on the social services. Mr. Layton says that though the rise of wholesome prices in India is only 41 per cent. (in 1928) above the level of 1913, the army expenditure is 66 per cent. above pre-war, and that at the pre-war rate it ought to be Rs. 44 crores instead of Rs. 55 crores. Since 1928 prices have fallen precipitately, the index number for June 1930 being 116. So the figure to-day would be not 44 but Rs. 36·3 crores. It is a bit surprising that Mr. Layton does not refer in this connection to the Report of the International Financial Conference of Brussels, 1920, wherein 20% of the national expenditure devoted to defence is stated to be something 'that the world cannot afford.' Thirty-nine countries of the world, including India, and representing 75% of the world's population participated in that conference and made unanimous recommendations. The Indian ratio, as Mr. Layton points out, is 62½ per cent. of the Central expenditure and 31½ per cent. even of the Central and Provincial expenditure taken together. According to the Brussels standard, an expenditure even of Rs. 35 crores on defence would be unjustifiable. Thus it is clear that there is room for retrenchment of at least Rs. 20 crores in our expenditure on defence.

Then there is the question of economy in administration consistent with efficiency. Merely recruiting Indians in place of non-Indians for the superior services will not lead to much economy. Provincialising all these services will only mean an alteration of the level if inside the Provincial cadre we create a class A and a class B and have separate recruitment and separate scales of pay for the two classes. We must be clear that in civil administration as in the army it is two distinct types of persons that we require to recruit, *viz.*, officers and men. If in the army we expect to get and do get our highest officers—from Lieutenant-Colonels to General Officers-Commanding—from among young

men recruited as Second-Lieutenants, even so in civil administration we ought to be able to get our highest officers from among young University men recruited, say, as Mamlatdars (Tahsildars) or Subordinate Judges. With that kind of Provincialisation and Indianisation, there would open up a possibility, both of reduction of number of posts and of toning down the scales of pay, so as to reduce the present expenditure on superior services very appreciably, possibly by a good few crores in the whole of India. But neither Mr. Layton nor the Commission have seriously considered that line of retrenchment even if to show that not much would be achieved thereby. It is of course a question of policy, but it is idle to talk about finance without considering policy. Mr. Layton himself cannot get away from policy for he says that one of the two underlying assumptions in his report is "that it is both possible and desirable to improve the economic and social condition of Indian people by a substantial increase in expenditure on the nation-building services." His other assumption is that it is possible to raise additional revenues for this purpose. So without entering much into the propriety of present expenditure, he proceeds to consider how more money could be raised. He could, as a matter of fact, have made out a good case for the need of raising additional revenue, even after considering the possibilities of retrenchment, had he considered two items on the revenue side, *viz.*, liquor excise and salt.

Mr. Layton has calmly assumed that the revenue from liquor and salt would continue to come in as heretofore. Still more amazing it is to find the Commission dumb on the subjects. The latter-day movement against these two sources of revenue is merely a culminating point of the strong assertion of public opinion against them that has been made for three or four decades past. Any financial scheme that ignores public opinion in these two respects has small elements of stability in it. Mr. Layton, who estimates the need for more money for social services in the next ten years and the possibilities of additional

revenue by taxation during the period, ought not to have ignored the possible fall (may be, virtual extinction) in the revenue from liquor excise and salt, together amounting to more than Rs. 25 crores. He might, therefore, have said that the possible retrenchment in the military and administrative expenditure might largely be counterbalanced by the possible extinction of revenue from liquor excise and salt, and, therefore, additional taxation would have to be resorted to, if more money was to be found for the social services.

New Sources of Taxation.

Let us now consider Mr. Layton's proposals for additional taxation. As regards *Income-Tax*, his proposals for lowering the exemption limit for personal income-tax and also for steepening the progression of the rate are certainly to be welcomed and he deserves to be specially complimented for having made bold enough to advocate the abolition of the exemption of agricultural incomes. He would have liked to propose *death duties* but has been unable, it seems, to make up his mind. In view of the changes in the income-tax and the inclusion of agricultural incomes, it would probably be wise not to provoke further protests by proposing death duties just yet, but they would have to come in later.

As regards *tobacco*, Mr. Layton proposes an excise tax on cigarettes manufactured in India. That industry has as yet hardly got established in this country even with the help of heavy import duties. To imagine, as Mr. Layton does, that the industry will in ten years' time be so largely and so stoutly be planted in India as to be able to yield an excise revenue of Rs. 5 crores and yet stand the competition of foreign tobacco trusts seems to be the height of optimism. Those five crores had better be left out of consideration altogether, at least for the present. Let the industry grow and get firmly established in the face of foreign competition.

Exactly the same thing needs to be said about Mr. Layton's proposal of imposing an excise on *matches*. It is amazing that the rate he proposes is the same rate as the present import duty. He is not perturbed by the thought as to whether there would be any match-industry left alive to pay the excise at that rate. He calmly looks forward to collecting Rs. 3 crores out of it. Like the preceding Rs. 5 crores, these Rs. 3 crores too need not be seriously counted upon. Mr. Layton's mind seems to have pictured English factories, not Indian, before itself when it made these calculations.

Mr. Layton's proposal of a *terminal tax* may be welcome if it is restricted to imports and is also made a substitute for the municipal octroi wherever possible. It is meant to be a temporary tax, to be given up if and when road traffic in goods successfully competes with railway traffic. Mr. Layton counts upon getting at least Rs. 6 crores out of it, presumably in excess of the octrois for which it is to be substituted.

Mr. Layton's remarks on the *local cess on land* seem to be very casual. It is surprising that he should have failed to note that the Indian land revenue is itself a local rate in the English sense, being a particular fraction (anything from 20 to 50 per cent.) of the annual (or rental) value of agricultural land. The Indian local cess is a local rate on the top of a fairly heavy local rate, considering the smallness of the average agricultural holding in India. Had Mr. Layton compared the burden of land revenue in India with that of the land tax in European countries, he would have seen the picture in its proper proportions. The trouble with our land revenue policy has been that although land revenue has been collected on the principles of the English local rates, the money has never been expended on the English analogy, *viz.*, for purely local purposes. Unfortunately, very few even among Indian public men have grasped that aspect of the question. Most of the controversy on that thorny problem would probably die down if it was tackled on those lines. With the proposed taxation of agricultural incomes, the way has been

made clear to treat the present land revenue as if it was a local rate. But in saying this I have entered upon the next and the most important topic of the distribution of revenues.

The Distribution of Revenues.

On this the most vital part of the Indian financial problem, Mr. Layton's proposals are really disappointing. Little need be said about the Commission in this matter, because the Commissioners have done little independent thinking on the subject. The term, Financial Assessor, applied to Mr. Layton by the Commission, is in fact a misnomer. The Financial Assessor has really written the financial judgment which the Commissioners as judges have simply countersigned.

Mr. Layton should have started the consideration of this subject by enunciating the general theoretical principles which should govern the division of functions and resources between the Central and Provincial Governments and as between the latter and the Local Authorities. He should have drawn upon the practical application of those principles in the financial arrangements obtaining in Canada, Australia, the United States and Germany from which lessons for Indian federal finance could be suitably drawn, taking care to allow for abnormal factors like the excessive growth of national debts in some of those countries due to the late War, and the consequent need for the particular Central Governments to appropriate more of the national resources than they did before the War. The Taxation Enquiry Committee, to whose Report Mr. Layton refers now and then, had stated those principles, though it was unable to apply them to the Indian problem. There is really one principle, *viz.*, that the more direct a tax is, the more it should be spent in the locality where it is collected. As expounded by the Taxation Committee, the principles are :

- (1) Indirect taxes, with the possible exception of stamp

duties, are commonly Federal. (Excise duties are almost invariably Federal.)

(2) Taxes on corporation profits are also commonly Federal.

(3) Personal income-tax is generally a State or Provincial source.

(4) Taxes on fixed property are seldom Federal and tend to pass increasingly from State or Provincial to Local Authorities.

Applied to India this would mean :

(1) Customs, excise (including liquor, opium, salt), corporation tax (present supertax on companies), railways, currency would be the chief Central sources of revenue;

(2) Personal income-tax, stamps, forests, irrigation would be the chief Provincial sources;

(3) Land Revenue would be the chief source of revenue for (Bural) Local Authorities.

It is the ultimate destination that is indicated above, whichever may be the suitable authority for collecting a particular tax.

In the earlier part of his Report, Mr. Layton himself says :—“ The problem of financial relations between the central and provincial authorities in any country is ideally solved where the sources of revenue which, from the administrative point of view, fall naturally within the sphere of the Provincial Governments, harmonise so far as their yield and elasticity is (*sic*) concerned with the functions which are assigned to those Governments, while those which are naturally central sources accord with the functions of the Central Government.

“ One of the chief difficulties of the Indian financial problem is that this harmony between the distribution of functions on the one hand and the allocation of sources of revenue to the Provinces and the Centre respectively, on the other, is lacking. Indeed, the contrary is the case, for whereas nearly all the functions which will require large expenditure in the future fall

within the Provincial sphere, the revenue assigned to them show a quite inadequate increase, while the Central Government, whose expenditure should be stationary or falling, has assigned to it the only revenues which in recent years have shown expansion."

This shows a brilliant grasp of the subject, but Mr. Layton seems to have forgotten what he thus wrote earlier, when towards the end of his report he comes to consider the distribution of revenues. Otherwise, how is it that out of the two elastic sources of revenue, *viz.*, customs and income-tax, he not only retains customs, but also the major portion of the income-tax, 14 crores out of 20, for the Central Government "whose expenditure should be stationary or falling?" If the incomes of persons domiciled within a province, from whichever source those incomes may arise—agricultural, industrial, commercial, professional, what not—are taxed entirely for the benefit of that Province, and the Central Government is permitted to retain only the tax on corporation profits (our present supertax on companies), would not the considerations of theory and the requirements of practice both be satisfied? It is surprising that Mr. Layton should have been unable to see this. Similarly should he have noticed that of the functions requiring large expenditure in future, *i.e.*, those on which expenditure "is far behind Western standards, and indeed in many directions is almost non-existing," the most expensive, *viz.*, primary education, sanitation, medical relief, etc., fall within the sphere of Rural Local Authorities, and hence these latter must have a respectable source of revenue. Mr. Layton has nothing to say about it beyond casually suggesting that the local cess may be increased. Is not the annual (rental) value of agricultural land the natural source of revenue for these bodies, as the annual value of house property is the natural source of revenue for municipalities? In other words, must not the whole of our present land revenue be allocated to the Rural Local Authorities? Does that not satisfy both the theoretical and practical requirements in that matter?

Mr. Layton, with his knowledge of English local finance, should have been the first to advocate this reform, particularly when the Taxation Committee's Report had virtually accepted the logic of this claim. In short, the harmony between functions and resources would in a large measure be achieved by allocating customs and corporation tax to the Centre, personal income tax (including tax on agricultural incomes) to the Provinces and land revenue to the (Rural) Local Authorities.

Excise of all kinds (including liquor, opium, salt) is but a counterpart of customs and must naturally go with it. That is theory. But practice also requires that to be done in India. One of the financial blunders of the Reforms of 1919 was the allocation of liquor excise to the Provinces. In province after province, particularly in Bombay and Madras, the Governments during the last ten years have found themselves entirely helpless to meet the emphatic demand of their Legislative Councils in favour of Prohibition. It was Mr. Layton's business, and most certainly that of the Commission, seriously to consider this problem, when the working of those Reforms was being examined and fresh proposals were to be made. The liquor problem, if it is to be tackled properly, must be tackled as an all-India problem, including the Indian States. The Central Government alone can initiate and enforce an all-India policy in this matter. The liquor excise revenue amounts roughly to Rs. 20 crores in the whole of British India. The Central Government alone can afford gradually to lose the whole of this revenue, if necessary, because its military expenditure is excessive by at least Rs. 20 crores, as I have shown earlier in this paper. Let the two policies of marching towards Prohibition and cutting down military expenditure progress side by side and the thing can be done without upsetting budgets, whatever period is fixed for reaching the goal. The Government of India will of course have to induce the Indian States,—and it knows very well how to do it—to be prepared to sacrifice liquor excise revenue, as some of them have already had to sacrifice opium revenue in the good

company of the Government of India, and to make up for the loss by taxing the personal incomes of their subjects, agricultural as well as others.

Mr. Layton, instead of proposing the transfer of liquor excise to the Central Government, as he ought to have done for the reasons stated above, actually advocates the entrusting of another mad dog to the Provincial care when he includes the proceeds of the salt duty in his Provincial Fund to be distributed among the Provinces on the "per capita" basis. Public opinion in the matter being what it is, the proceeds of the salt duty must be held in "suspense account" at least for some time. The proceeds may as a result of legislation vanish for aught we know or be very much reduced, the duty being lowered to a level where it is believed not to interfere with the maximum consumption of that necessity of life. The edifice of the Provincial Fund is not strengthened very much by making 6 crores out of its total of 14 crores arise from the salt duty. As a matter of fact, the other 8 crores—5 from cigarettes and 3 from matches appear to be very much more problematical as I have shown earlier. The valuable part of the Provincial Fund scheme is really the idea that far from levying contributions from the Provinces for expenditure which "should be stationary or falling," the Central Government, according to Mr. Layton, must now get used to the idea of contributing to the Provinces on a "per capita" basis to enable them to undertake expenditure on social services which, in spite of its care during all the five or six decades, "is far behind Western standards, and indeed in many directions is almost non-existent."

If the reallocation of resources which I have proposed above is made it means that the Central Government gets an additional Rs. 19.44 crores from excise, according to the figures adopted by Mr. Layton, and loses Rs. 9 crores of personal income-tax to the Provinces. Thus the Central Government has a surplus of over 10 crores, on the present basis of revenue and expenditure, and the Provinces will have an equal amount of deficit.

So there will have to be contributions from the Central to the Provincial Governments enabling each of the latter to start with a balanced budget and such contributions will have to continue till the Provincial deficits are made good by the application of part of the proceeds of the new taxes proposed by Mr. Layton, *viz.*, the taxation of agricultural incomes, lowering of the exemption limit, steepening of the rate of progression, and terminal tax.

The scheme that I have thus outlined gives a fairly clear-cut division of resources and achieves that harmony between functions and resources for the Central and Provincial Governments and also for the Rural Local Authorities—harmony which Mr. Layton approves but which his scheme hardly can be said to provide. Further, my scheme makes it possible to inaugurate new policies in consonance with public opinion, *e.g.*, reduction of military expenditure, adoption of the goal of Prohibition, abolition or reduction of salt tax, etc., which would be hardly practicable, in my opinion, under Mr. Layton's scheme blessed by the Simon Commission.

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