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Evolution of Fiscal Federalism in the Colonized India

By

Rajesh Kumar*

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Abstract

In order to understand the true essence of the existing federal structure in India, it is very much required that there should be a proper understanding of the events and circumstance which led to its progressive evolution. Thus, while considering this aspect, the present paper is focused on the analysis of evolution of federal financial relations during British rule in India. The paper has been categorised into six phases: the first phase covers the introductory part, the second phase covers the analysis of the cementing of theoretical base for decentralisation (1860-1871), the third phase provides the informal progress to the ongoing process of decentralisation (1871-1920), the fourth phase evaluates the formalisation of decentralisation (1920-1937), the fifth phase analyse the Centre-Provincial relations under the formal Federal structure (1937-1947), and the last phase provides discussion on Federal financial relations in the transition phase (1947-1950).

Key-words

Decentralisation, Devolution, Fiscal Federalism, Colonial Rule, Reforms etc.

1. Introduction

Generally, the de-facto aspect of the federal concept explains that even a huge landmass with large population and with full of diversities (such as social, cultural, geographical, political and economical etc.) can be administered in a peaceful way, provided it contains the mechanism for a balance in Power and resources sharing between federal and regional units of the governments. And this balancing factor is determined by variety of factors such as- the mode of creation of the federal structure and experiences from various phases of ups and downs etc. In Indian context this phenomenon can be understood by observing the developments that took place during the colonial rule in India.

On the evolutionary aspect, it can be said that although federal concept is an age-old concept and it takes its shape as per the prevalent system of the government. And when we look at the existing federal structures, it can be observed that although the modern type (Federalism which is based on a democratic form of government system) of federalism is considered to be originated on the pattern of the United States of America and Canada. But even before this, there are examples in the history of mankind that there have been many instances where the unitary and federal form of government system worked one after the other.

To put it simply, the growth of the concept of federalism or decentralisation can be described as natural consequence of basic state of affairs. The history speaks loudly and explains that whenever there is need to govern a large territory with full of diversities then there is a non-negotiable need for the division of the administration and available resources in some manner so that the proper functioning of the administration can be worked out. Further, in ancient and the medieval times also, there was existence of federal kind of structure, but it was not based on principles as we are experiencing nowadays (i.e. principles of democratic governance). For example, in ancient India the King Ashoka (Belonged to the Mauryan Dynasty and ruled from 269 BC to 232 BC) as well as King Samundra Gupta (Belonged to the Gupta Dynasty and ruled from 336 AD to 380 AD) established a large empire which expanded even beyond the boundaries of today's India. And they administered this vast land by dividing it into various provinces and sub-provinces on the basis of the requirement of their time. Similarly, in the medieval time during the Akbar (Belonged to the Mughal Dynasty and ruled from 1556 AD to 1605 AD) and his successors reign the Indian subcontinent was ruled by dividing the whole administration into provinces and districts.

Further, when we talk about the modern time especially in Indian context, we usually consider it with the advent of colonial rule. While looking at the historical part of this modern phase we can see that even the colonial power (i.e. Britishers) were no exception to this basic understanding that the vast and diversified territory can only be managed through some sort of decentralisation in administration. And, when these Colonial rulers became the dominant power in India, they began to realise that if they want to rule India then they have to follow the natural consequences of India's diversities (i.e. decentralisation of the administration).

Additionally, during this historic phase, the Britishers being the colonial power made every change which could serve the colonial interest whether it was related to social change, economic reforms, administrative moulding or the political restructuring. Moreover, everything was governed with the sole motive to squeeze India's wealth and in order to serve this prime objective they framed the financial administration in such a way so that it not only ensures the economic efficiency in administration but can also help them to strengthen the hegemony of the colonial government. With all this background the British colonial government in India from time to time kept on changing their policies so that they could maintain and enhance their grip over the Indian subcontinent.

With briefly touching upon the history of the colonial rule in India we can see that in the beginning the British rule in India was based on the philosophy of strict form of centralisation. The legal history of the British colonial rule in India explains itself that the unitary form of government was the principle and that principle got its initial significance from the stream of legislations such as- Regulating Act of 1773; Pits India Act 1784; the Charter Act of 1793; the Charter Act of 1813; and further reinforced by the enactment of the Charter Act of 1833.

Furthermore, building upon the same stream of thoughts and with the analysis of the Charter Act, 1833 it can be observed that the Act was aimed to establish a unitary form of government in India. Further, that Act established a kind of centralised administration in which the Governor General of India and its Council were vested with all the powers of direction, control and the superintendence of the whole military, civil and revenue administration in India (Mishra 1963: 30). In those circumstances, without the prior sanction of the Governor General-in-Council, the provinces were not having any discretion to spend revenue for the purpose of creating new post, or making arrangement for grant of salaries, allowance or gratuity (Mishra 1963: 30). This all depicts that at that point of time a sort of unitary grip was being practiced.

Additionally, that process of strict centralisation continued even after the crown took over Indian administration (as a consequence of India's freedom revolution of 1857) and finally that culminated into a kind of administration where the mismanagement of the financial affairs became a new norm and consistent headache for the imperial government.

All these above-mentioned circumstances created a sort of compulsion for the imperial government to initiate the process of decentralisation of the financial administration. And that process of decentralisation had no option of returning back to the centralisation and moreover it kept on expanding its sphere until it culminated into a formal fiscal federal structure.

Thus, in order to have a better assessment of the historic evolution of the fiscal federalism during the colonial rule in India, we need to have a critical analysis of this historical process in various phases. Further, each phase of this evolution has covered not only the process of refining the financial relations between the supreme government (Central government) and the provincial governments but also presented the assessment of the role and effect of the prevalent circumstances and the ultimate intention of these colonial rulers.

In short, this paper has tried to cover analysis of the historic evolution of fiscal federalism (in the time span of 90 years i.e. 1860-1950) which can be observed in the following sections:

- Cementing the theoretical base for decentralisation (1860-1871)
- Informal progress of the process of decentralisation (1871-1920)
- Formalisation of the process of decentralisation (1920-1937)
- Centre-Provincial relations under Federal structure (1937-1947)
- Federal financial relations in the transition phase (1947-1950)

2. Cementing the Theoretical Basis for Decentralisation: 1860-1871

This phase continued with the ongoing practice of strict form of centralisation in the financial matters. But additionally, this phase had also witnessed that the prevalent system of centralisation had started showing its negative side i.e. mismanagement of the financial administration. However, on the ideas level a consensus was evolving that there should be decentralisation of certain financial powers and responsibilities which are of local governance level. But, in practice the supreme government was not ready to accept the devolution of financial powers. So, this adamant attitude of the supreme government led to the piling up of the fiscal deficit (Keith 1936: 183-185).

Further, this highly unitary system of finance had provided numerous ways of gross abuses by the provinces. However, the provincial governments were the real administrator of the country, but they were kept without any form of financial responsibility. As a principle it is well known that an efficient working of the economy comes only with the responsibility. But in the prevalent system in that phase of the history the provinces were free from this responsibility aspect. And this separation of responsibility from the finance consequently led to the provincial extravagance. Further, the responsibility to find the new avenues of revenues was with the supreme government and the provinces were free to demand as much as they want. Thus, all this led to the competition among the provinces to give justification for their ever increasing demands for finance. The circumstances were that the provinces were of view that they had a resource from which they can withdraw without any limit. This presumption was developed because they had no experience of the co-relation between the economy and responsibility. By their experiences the provinces found that the less economy they practiced, the more they have chances to prove their urgent requirement of the funds.

Thus, the distribution of the resources to the provinces were not based on any well-defined principle or formulae such as- availability of resources, expenditure requirement or the needs etc. But it was based upon the relative demands, which the provinces could make on the supreme government's revenues. The result in the words of General Strachey, was that 'the distribution of the public income degenerates into something like a scramble, in which the most violent has the advantage, with very little attention to reason' (Mishra 1963: 32).

Further, there was no well-established system of account and audit and due to that the supreme government could not exercise any effective control over the provincial expenditure. The prevalent system can aptly be described in the words of Dr. B. R. Ambedkar, so as the government of India remained without an appropriation budget and a centralized system of audit and account, it continued to be only a titular authority in the matter of financial control, and the provinces, though by law the weakest of authorities in financial matters, were really the masters of the situation (Mishra 1963: 32).

Besides the above-mentioned state of affairs even the new legislative development in the form of India Councils Act, 1861 also could not break the stream of rigid centralisation. Consequently, the deficit and the level of debt of the central government were piling up every year. The financial situation was so grim that even the new initiatives (such as introduction of proper budget system, uniform system of accounts etc.) taken by Mr. James Wilson (Financial member of the Governor General-in-Council) could not bring any improvement in the worsening fiscal condition.

Additionally, although the provincial governments were the main collecting authority of all the revenue, but they were doing so merely as an agent of the central government. Thus, the provinces have no direct interest in the whole proceeds of the collected revenue. Furthermore, the provinces were getting funds on the basis of what they were expending thus they were tempted to ask for more and more funds and tried to spend every pie without considering of any return for that expenditure. Thus, all this was worsening the fiscal condition of the central government (Kumar et al. 1983: 905).

Further, moving towards the reformative stream of thoughts, the initiatives taken by Mr. Samuel Laing who succeeded James Wilson also made some progress by stressing the need for the decentralisation of certain financial powers which includes devolution of taxation powers to the provinces. This all was being suggested only to rationalise the finances of the government of India.

While concluding this phase of moving towards decentralisation, it can be said that although there was no substantial change in the ground realities which can be described as a beginning step towards the devolution of the financial powers. But this phase has made the substantial changes in the thought process, now the central government at least theoretically convinced that they need to move towards the decentralisation. As it is well known that actions follow the ideas, similarly circumstances and events of this phase had made the changes at the thought process level which provided the conceptual basis for taking the actions in the next phase. Finally, we can say that this phase had provided the ideological cementing to need of incorporating the financial responsibility in the working of the provincial governments by using the tools of decentralisation which we will clearly see in the form of Mayo Resolution in the next phase of fiscal devolution.

3. Informal Progress of the Process of Decentralisation: 1871-1920

The nomenclature of informal progress is given while keeping the circumstances in mind that there was no declared objective of decentralisation in that phase. Further, that phase of informal progress was a result of hit and trial experiments. In this phase the central government took various initiative such as- Mayo Resolution of 1870; Provincial Financial Settlement (1882); Charles Elliot Committee (1887-1888); Quasi-Permanent Settlement (1904); Royal Commission on Decentralisation (1908) and Permanent Settlement (1912) etc. In order to have a deep understanding, we need to have detailed analysis of the changes that took place in that phase.

That phase began with transforming the thought process of the last decade into reality. In 1871 the famous Mayo resolution or scheme was declared. That scheme was aimed to bring in soundness in the Imperial finance which was in the state of chronic deficit (Copland 2001: 17-19). The broad objectives of the Mayo Scheme can be observed from the wordings of Lord Mayo (Mishra 1963: 34), "the more we will give the financial administration in the hands of the local governments the more it will lead to the efficiency and economy in the administration. Further, it will also increase the sense of responsibility in the provinces and ultimately will result in instituting the Empire in various parts of India and finally will lead the more and more association of natives with the administration".

Further, the Mayo Scheme brought in various changes in the existing financial relations between the Imperial and the Provincial governments. The main features of this Scheme have been provided in the following words (Sury 2008):

- It promoted mainly two causes, firstly providing the relief to the Imperial government from the ever-increasing level of fiscal deficit and secondly, imbibing the sense of financial responsibility among the Provinces.

- It made the provision for the devolution of certain heads of expenditure such as – Police, jails, registration, education, medical services (excluding medical establishments), civil buildings, printings, roads and certain miscellaneous public improvements etc to the Provinces.
- Further, for the purpose of bearing the burden of the above-mentioned heads of expenditure, the Scheme assigned the receipts of the abovementioned corresponding heads to the Provincial governments.
- Besides this in order to fulfil the increased burden of expenditure the existing system of fixed grants from central government to the provinces was also continued.

Besides these Features, the Mayo Scheme when tested on the actual ground it revealed various defects such as- it was lacking the adequate resource arrangement for the Provinces. And moreover, it did not make the arrangements for the progressive administration of the subjects transferred to the Provinces. Additionally, it did not provide for the year on year revision of the fixed grants, as the expenditure was increasing but the base year (i.e. 1870-71) for calculating the grants remained fixed. Further, the scheme did not consider the existing inequality among the Provinces with regard to the expenditure burden and the grants. The allocation of the grants was also not based on the fair principles as the conditions of the Provinces were not equal. All this showed that the real motive behind this scheme was not to devolution of functions and powers to the Provinces but to provide some sort of ease to the imperial finance.

The system provided by the Mayo Scheme although did not provide a complete solution to the financial problem of the Imperial government, but it at least provided a kind of beginning which could not be stopped in the time to come. And the initiation of financial decentralisation given by the Mayo Scheme ultimately culminated into formation of the formal fiscal federalism.

After the Mayo Resolution the next wave of informal financial decentralisation came in the form of widening the scope of Provincial Financial Settlement. In 1877 Lord Lytton with the assistance of his finance member Sir John Strachey made changes in the existing state of affairs and brought into picture a new scheme for informal decentralisation of the financial relations. Under this new scheme some more heads of expenditure such as- law and justice, land revenue, stamp, excise, general administration and stationary and printing etc. were transferred to the Provinces. But strange thing was that the Provinces were not given the power of taxation upon these transferred heads of expenditure. On the other side the Provinces were given share in the revenue of the Central government. One more significant feature of this arrangement was that the Provinces were not only allowed to keep the revenue from some minor heads of revenue but it also provided that whether there is surplus with the Province or deficit, it would be shared equally with the Central government. Thus, it created an informal beginning of the formal federal financial relations.

Like earlier schemes this scheme was also not free from drawbacks. Some of the major drawbacks of this scheme are as follows: (a) that scheme was lacking any kind of uniform pattern of transfer of subjects, (b) the provinces were kept out of the sharing from the largest source of revenue i.e. land revenue etc. Despite these defects this system brought in a sort of flexibility in the revenues of the provinces.

The Mayo Scheme was having a condition of annual revision but in the year 1882 Lord Ripon with the assistance of his financial member Major Baring made some changes in the existing Provincial Financial Settlement. Under this stream of reform, the annual revision of settlement transformed into a settlement which required revision after every five years i.e. Quinquennial arrangement. Further, under this new scheme the system of shared revenue or the divided heads came into existence. This was the first time the revenue was classified under three main heads i.e. Imperial, Provincial and Divided. The main subjects under these heads are as follows (Jha 1983: 68-69):

I. Imperial
   1. Military public works
   2. Revenue from opium
   3. Custom duties (except in Burma)
   4. Telegraphs
   5. Gains by way of exchange transactions
   6. Tributes
   7. Post office receipts
   8. Revenue from salt (except in Burma)
   9. Railways

II. Provincial

1. Interest on provincial securities
2. Education
3. Provincial rates
4. Receipts from law and justice
5. Medical receipts
6. Stationary and printing
7. Minor departments
8. Police
9. Ordinary public works
10. Provincial railways
11. Miscellaneous items (except gains by exchange premium on bills etc.)

III. Divided (Heads with unequal division)

1. Excise
2. Forests
3. Registration
4. Stamps
5. Land revenue
6. Assessed taxes

Besides this division on the basis of revenue, there was also corresponding division of the heads of expenditure. But this whole distribution was imbalanced, and the provincial governments were facing the situation where the expenditure was much more than the corresponding sources of revenue. The main objective of this Quinquennial arrangement was to create a greater financial stability in the Provinces, but in reality, it increased the imbalance among the Provinces and also created the friction and irritation in relationship among them. Furthermore, another major defect of this system was that on the completion of every five year the balances standing on the credit of the Provinces were taken over by the Government of India.

The Quinquennial arrangement was revised in the year 1887 and 1896. And, again in 1904 the defects of this system became quite visible and Lord Curzon (the then Governor General of India) made some efforts to improve the conditions. Under the new reforms in

1904 the Central Government introduced a scheme which was quasi-permanent in nature. Although, this scheme did not make any change in the classification of the subjects which was introduced by the Quinquennial arrangement, but it modified the share of the Provinces. Under this quasi permanent settlement, the whole revenue from the subjects of national importance (i.e. customs, salt, post, mint, railways and mines etc.) were appropriated by the national government and the share of revenue from the subjects of local nature (i.e. police, education, civil works, medical services etc.) were given to the Provinces. Although, the revenues given to the Provinces were fixed but that could be revised only by the supreme government, provided there are substantial changes in the original circumstances. Due to these arrangements the overall expenditure burden of the Provinces had exceeded their revenue generation capacity. So in order to fill this gap there was provision for the lump sum grants. However, the quasi-permanent settlement did not make any big change but, it strengthened the existing stream of reforms which was initiated by the Mayo Scheme.

Further, in order to improve the financial relation with the provinces, the Supreme government in 1908 appointed the Royal Commission on Decentralisation which presented its report in 1909. The Commission though convinced with the existing financial relations but still emphasized for reorganization of Indian financial system. Some of the major recommendations by the Commission are as follows:

- It suggested that the provisions of divided heads are not good for the provincial development.
- The system of fixed assignment had made the arrangement unduly rigid.
- The definite purpose lump sum grants had provided the unnecessary scope for interference in the Provincial matters.
- These Provincial settlements had discriminated among the provinces.
- As the existing arrangements lacked any power to the provinces for additional taxation or borrowings, thus it excluded the provinces from taking any measure for improving the administration.

As a result of these recommendations Government of India again came with a new kind of financial arrangements in 1911-1912. The new arrangements initiated by Lord Hardinge (the then Governor General of India) were given the nomenclature of Permanent

Settlement. Under this arrangement, the forest revenue and expenditure were completely given to the provinces. The new system was kept rigid and permanent but there were provisions if any contingency arises. Besides this, the provisions for grants to the Provinces were retained. Further, the Government of India was given the authority over the expenditure and the revenue from the following heads: military receipt, mint, tributes from native States, customs, Railways, Opium, telegraph, salt, post office and Home Charges etc. And the other heads were either divided between the Imperial and Provinces or totally given to the Provinces. But, the provisions of the Permanent Settlement did not allow the Provinces to adjust the funds as per their changing needs.

The Permanent Settlement continued till the implementation of the Montague-Chelmsford reforms i.e. 1920. During the period of 1912-1920 the revenue could not satisfy the growing level of expenditure. Further, the self-regulatory kind of system provided by the Permanent Settlement could not sustain for long time in a fast-changing federal adjustment. Although, as it is a very well-known fact that no system can make arrangements for all the times to come. Thus, the Permanent Settlement also proved to be ineffective for the circumstance prevalent in the beginning of 1920s. The next phase (1920-1937) marked a formal beginning of the federal concept in Centre-State financial relations in India. This phase provided the required impetus to the developing fiscal federal relations.

4. Formalisation of the Process of Decentralisation: 1920-1937

The process of formalisation of fiscal federalism got initiation with the implementation of the Government of India Act, 1919 (also known as Montague-Chelmsford reforms). This phase because of administrative and financial changes usually called as the beginning of formalisation of federal financial relations. Further, this phase had also made various kinds of experiments in the Centre-Sate Financial relations such as: Montague Chelmsford Reforms, Meston Committee, Taxation Enquiry Committee (1924), Indian Statutory Commission (1930), 1st Peel Committee (1931), Percy Committee (1932), White Paper on Constitutional Reforms (1931), 2nd Peel Committee (1932), Joint Parliamentary Committee on Indian Constitutional Reforms (1933-34) etc. And, in order to have clarity as to how the fiscal federalism get cemented as a part of formal administration, we need to analyse the above-mentioned reform initiatives in a bit detail.

In 1919, the continuous and unstoppable process of decentralisation got a required shot in the arm by the enactment of Government of India Act, 1919. This Act was based on the reforms suggested by the Montague-Chelmsford Committee. That Committee was tasked with the objective to find out the totally separate resources for the Centre and the Provinces. The report opined that the financial autonomy to the Provinces could only be secured by separation of their resources from the Central Government. The main features of these reforms can be perused in the following ways (Jha 1983: 78-79):

- It provided the limited responsible Government at the Provincial level.
- It classified the subject matters into two categories i.e. Central and Provincial.
- The subjects containing the broad spectrum were given to the Centre, such as: Foreign affairs; post and telegraph; Military matters; customs and tariffs; public debts; coinage and currency; railways; commerce and shipping; civil and the criminal laws etc.
- The subjects given to the Provinces were further sub-divided in two categories i.e. Reserved and Transferred. The reserved list contained the subject such as- the Police; Prison; administration of justice; Land revenue; factory regulation and labour affairs etc. And under the transferred category the subjects included were- public health; cooperative societies; public works; agriculture and veterinary questions; sanitation; local self-government; hospital; asylum etc.
- Under this scheme the old system of divided heads of revenue was discontinued.
- Under the new scheme the subjects such as- land revenue; irrigation; excise; forests; and judicial stamps were completely transferred to the Provinces.
- It proposed a kind of mechanism where Provinces were given the autonomy for self-governance with the federal government as protector and arbitrator for inter-Provincial relationship.
- Under these reforms the taxation powers of the Provinces enlarged.
- The Provinces were conferred with the borrowing powers and were made entitled to enter the money market on their own behalf, so this provided the ever-required financial independence to the Provinces.

- Further, on the expenditure side, the Central government tasked itself with the responsibility to take care of the cost of defence and the commercial services like-railways; civil works; and the post and telegraph etc.
- And finally, the Provinces were empowered to frame their completely separate budget.

However, with the above mentioned features the Provincial set up was given a formal shape of units in a federation but, in practice it removed the major source of revenue from the central share and consequently it led to a huge deficit in the federal finance. Thus, in order to meet this challenge, the central government appointed a Financial Relations Committee under the chairmanship of Lord Meston. The Meston committee recommended against the division of the income tax with the provinces. It further suggested that general stamps for the administrative and financial standing should be provincialized. It also suggested that the scheme for initial contribution and standard contribution should be limited up to seven years only. And that contribution would be based on the taxable capacity and economic condition of the Provinces. Although, some of these recommendations of that committee were accepted but the suggestion relating to the sharing of income tax was not accepted. The Meston award was the only instance in the history of Indian fiscal devolution, where the Provinces were required to make the contribution to the Central revenues.

Further, in the meantime in order to solve the issue of division of sources of revenue between the Centre and Provinces, the Indian Taxation Enquiry Committee headed by Sir Charles Todhunter was constituted. The Todhunter committee recommended that excise duty on the opium; country made foreign liquor and general stamp should be reassigned to the Centre. It also recommended that the Centre should share a small portion of the corporation tax with the Provinces. Although, none of the above given recommendations of that committee were accepted. Further, the committee was neither in favour of giving the income taxation power to the Provinces nor in favour of imposition of surcharge by the Centre for the benefit of Provinces.

In the series of reform initiative of this phase, next came the report of the Indian Statutory Commission, 1930. This Commission accepted most of the recommendation of its financial assessor Sir Walter Layton. Layton suggested that in order to satisfy the claims of the industrial Provinces a substantial part of the income tax should be given to these Provinces. He also appreciated the methodology for proposed division, as suggested by the Todhunter Committee. The Commission also suggested that the income tax exemption given to the income from the agriculture should be done away with in a periodic manner and the income from it should be wholly assigned to the Province of origin. Sir Layton also suggested that a special Provincial fund should be formed in which the income from the taxes on commodities such as matches and cigarettes and also duties from the salt etc. would come. Further, the share from this fund among the Provinces would be based on the per capita (Sury 2010: 14-15).

Further, the Centre-State financial relations were also discussed by the Federal Structure Committee of the 2nd and the 3rd roundtable conferences (held in 1931 and 1932 respectively) through its two sub-committees. These two sub committees were presided over by Viscount Peel and known as Peel committee-I and Peel committee-II. In between these two committees another Expert Committee presided over by Lord Percy had presented its reports. The analysis of the findings of these committees has been covered in the following paragraphs.

The 1st Peel Committee recommendations are as follows:

- The proceeds of the income tax should be transferred to the Provinces and its collection and administration should be kept with the Federal government.
- It indirectly suggested that the whole federal tax revenue should be derived from the proceeds of the indirect taxes.
- And if there is any federal deficit then the Provinces should make the contribution to meet any such requirement. Further, this provision would be gradually terminated in 10 to 15 years.
- And if there is any permanent surplus due to this arrangement then that should be distributed as per the wishes of the federal government to the Provinces as an alternative to reduction of taxation.
- It also suggested that the Constitution should lay down the share in the available fund among the provinces on the basis of some criteria whether it is based on revenue or population or some other criteria.

- It also recommended for an expert committee to devise a criteria on which the income tax among the Province should be allocated.

Thus, on the issues raised by the 1st Peel Committee, an expert committee headed by Lord Percy was appointed. The Percy committee on the issue of distribution of the income tax suggested that the allocation should satisfy the following three tests: (a) It should be easy to understand and administratively workable. (b) It should deliver the results that should be fair and acceptable to the Provinces. And (c) it should be compatible with the idea of federation with provincial autonomy.

While keeping the above given requirements the Percy committee suggested the following scheme: (a) the corporation tax which paid by the residents in the federally administered areas and the tax paid by the federal officer from on their salary should be left with the Centre. (b) The remainder of the net proceeds should be transferred to the Provinces with consideration of population as a factor for deciding the share. Further, it was suggested that the scheme should not revised before the completion of five years. And with regards to the provision for grants it is suggested that if it is feasible then it should give to the Provinces on the basis of their population size.

Additionally, the 2nd Peel Committee further suggested that there should be two-fold divisions of the income tax proceeds. Firstly, there should be permanent Constitutional provisions for the share of the Federal government and secondly, similarly there should be Constitutional provisions for the permanent share for the Provinces. Besides these recommendations, there was another reform initiative in the form of White Paper on Indian Constitutional Reforms, 1931. Under that paper it was suggested that a prescribed percentage (i.e. 50% to 75%) from the net proceeds of the income tax revenue should be assigned to the Provinces. Further, the paper suggested two new features. Firstly, it recommended that the Federal legislature should be empowered by law to assign the tax proceeds from certain heads such as excise duties, salt duty etc. to the Provinces. And secondly, in case of certain taxes the power to levy tax would remain with the federal government but their proceeds may be transferred to the Provinces. The proposals suggested by white paper were also accepted by the Joint Parliamentary Committee on Indian Constitutional Reforms, 1934. And furthermore, the Parliamentary committee suggested that the share of the Provinces in the proceeds of the income tax should be decided by an Order-in-Council. It also proposed that the Provincial share should not exceed 50% of the total income tax proceeds and the Provinces should not be given power to impose any sort of surcharge on the personal income tax (Sury 2010: 18-20).

Although, the major theme of the above given recommendation to devolve more and more financial powers to the Provinces, but in reality, the idea of transferring the proceeds of income tax to the Provinces and later on covering the Federal fiscal deficit from the Provincial contribution was wholly discarded. Further, the major significance of the measures took place in this phase was that it provided the formal shape to the fiscal side of the Indian Federal structure. As, these arrangements were not based on the purely federal principles therefore these were mainly guided by the political exigencies. In broad terms it can be said that the reforms initiated by the Act of 1919 were proved to be another landmark in the long journey of the evolution of the fiscal federalism in the Colonised India. The end of this phase had set the stage for further reforms which later on came in the form of Government of India Act, 1935.

5. Centre-Provincial Relations under Federal Structure: 1937-1947

When the Act of 1919 was implemented it came up with several limitations. Further, the working of the Fiscal federal arrangements was analysed and evaluated by the three roundtable conferences and the Joint Parliamentary Committee on the Indian Constitutional reforms (1933-34) and on the basis of their recommendations the Government of India Act, 1935 was passed. The Act of 1935 made the formal declaration for setting up of a federal structure and made the elaborate provisions for this purpose. That Act also proposed a scheme of categorisation of the functions and the resources in three categories. Under this arrangement the subjects of Central interest were covered under the fold of Federal list which contained 59 entries. Similarly, the matters related to the Provincial interests were categorised under the Provincial Legislative List which contained 94 entries. And lastly, the subject which were touching the common interests of the Centre and the Provinces were maintained in a new list under the name of Concurrent legislative powers and it contained 36 entries. These provisions had made it clear that the structure created by this Act became the foundation for the Fiscal Federalism under the Constitution of India (H.L. Bhatia 1993: 341).

The Act of 1935 was another milestone in the evolution of Fiscal Federalism in the colonised India. The description of this Act was very aptly given by D.D. Basu, "while under all the earlier Acts and reforms the Government of India was in the unitary form but the Act of 1935 for the first time prescribed a federation, taking the Princely States and the Provinces as its units. But the provisions of the Act kept it optional for the Princely States to join the Federation and they did not join it. Consequently, the Federation prescribed by the Act of 1935 never came into existence" (Basu 1987: 9). The arrangements for the allocation of the resources to the Federal and the Provincial Governments, as had been given in the Act of 1935 can be classified into following four categories (Mishra 1963: 110-111):

- Taxes levied, collected and retained by the Federal Government: this category includes the item like- import and export duties; post and telegraphs; corporation tax; receipt from the railways; currency and coinage; and the military receipts etc.
- Taxes levied, collected and retained by the Provincial Governments: it includes land revenue; irrigation; duties on succession to agricultural land; capitation tax; taxes on minerals rights; excise duty of narcotics and non-narcotics drugs; excise duty on opium; alcoholic liquors; on medicinal and toilet preparations manufactured and produced in the Provinces; taxes on trade; profession and other employments; taxes on sale of goods and advertisements; cesses on the entry of goods in local area; duties on passenger and goods transported on inland waterways, tolls etc.; taxes on luxuries, entertainment; gambling and betting; stamps and registration related duties; taxes on animals etc. Thus, all this shows that these entries were of mainly local connection and further it could be better managed through the Provincial administration.
- Taxes levied and collected by the Federal government but assigned and shared with the Provinces: The taxes and duties which were assigned to the Provinces include stamp duty on bill of exchange, promissory notes, cheques, bill of lading, insurance policies, receipts, terminal taxes, and duties on the succession to the property other than the agricultural land. Similarly, taxes which were shared with the Provinces covered under the following entries- salt duties; a percentage of net proceeds of taxes on income excluding the agricultural income; excise duties on the subject

which are not included in the list on which the State excise duties applies such as duties on tobacco, export duty on the jute and jute products which were distributed among the Provinces. The sharing theses taxes and duties under the Government of India Act, 1935 although in the beginning would be based on the executive order but later on would be determined by the legislative measure.

- Provisions for Grants-in-aid and borrowings: The gap in the responsibilities and resources of the Provinces would be supplemented by the grant-in-aid by the Federal Government. Further the Provinces were also given the freedom that they could borrow from the open market but for that purpose they were required to have the prior sanction of the Government of India.

The special feature of the Act of 1935 was that for the first time the revenues and the account of the Provincial governments were separated from the Government of India. The Provinces were free to frame their own budgets and responsible for their ways and means. Although, the Act of 1935 provided the structure for a fiscal federalism, but it left many questions to be answered before it can be made functional at the ground level. Thus, in order to solve these problems an enquiry committee headed by Sir Otto Niemeyer was appointed. The Committee was tasked to give recommendation on- (1) the percentage of shared taxes to be given to the Provinces and for evolving the principle on which that would be disbursed to the Provinces, (2) grant-in-aid to the Provinces in order to overcome their debt liabilities. While considering these terms the enquiry committee made the following recommendations (Sury 2010: 24):

- 50% of the net proceeds of the Income tax should be assigned to the Provinces but it does not include the proceeds from the corporation tax.
- Share of the provinces which are growing the jute in the jute export duty should be raised by 12.5% to 62.5% of the net proceeds of the duty.
- The debt which are outstanding to the Centre and contracted before the April 1, 1936 by the provinces namely- North-West Frontier Province, Bengal, Orissa, Assam and Bihar should be cancelled and the similar debt of the Central Province should substantially be reduced.
- Annual grants-in-aids of varying amount should be made for United Province, Orissa, North West Frontier Province and Assam.

The above provided recommendations by Sir Otto Niemeyer were accepted as it is by the Federal government and were incorporated in the Government of India (Distribution of Revenue) order, 1936. While considering the emergent situation during the 2nd world war these recommendations were made subject to change under the above-mentioned Order. Thus, with the above-mentioned changes of this phase it can be concluded that the Act of 1935 provided a kind of ground preparation to adopt the provisions of Fiscal Federalism under the Constitution of India. The major changes in the transition phase of 1947 to 1950 can be analysed in the next phase of evolution.

6. Federal Financial Relations in the Transition Phase: 1947-1950

The Independence brought in many changes in the Centre-State fiscal relationship. Especially the partition of the country compelled the Constitution framers to rethink about the idea of loose federal set up with maximum autonomy to the Units. Although the scheme suggested by Sir Otto Niemeyer was retained. But, as due to partition the Jute industry was affected. So, the Provincial share of the jute export duty was reduced from 62.5% to 20% which was broadly the share of the jute growing area which was transferred to the Pakistan. Further, during the Framing of Indian Constitution the provisions related to the Centre-State Financial Relations were referred to an Expert Committee headed by Nalini Ranjan Sarker. This committee after serious consideration provided a scheme for the financial relations and later after some modification that scheme was incorporated in the present Constitution. Major recommendations of this expert committee are following (Singhvi 1974: 149-150):

- The sharing ratio in the net proceeds of the income tax including corporation tax between the Centre and the Units should be 40:60.
- In order to balance the revenue structure of the Provincial governments, some share of the central excise duties should be given to the Provincial Governments.
- The sharing of the net proceeds of the jute export duty with the Provincial governments should be done away with.
- A Finance Commission should be constituted to handle the matters related to the distribution of revenue between the Centre and States.

Besides this, after the partition of the Country the arrangements related to the allocation of income tax and the jute export duty caused discontent among the States. So, in order to solve that problem, the matter was referred to C.D. Deshmukh. The Deshmukh award (1950) suggested that with regard to the changed percentage, the recommendation of the Niemeyer award can be applied by deducting the share of the areas transferred to the Pakistan. And while considering the issue of jute export duty the Deshmukh Award recommended for varying amount of grant-in-aid to the affected provinces. The Award suggested that following amount (in rupees) of grants-in-aid- West Bengal (105 lakhs), Assam (40 lakhs), Bihar (35 lakhs) and for Orissa (5 lakhs). This Award came into force on April 1, 1950 and remained effective for two years and ended on March 31, 1952.

7. Conclusion

In summing up the analysis on the evolution of Fiscal Federalism, it can be observed that the process of fiscal decentralisation which initiated in the 1860s had gone through various ups and downs and ultimately shaped the administrative structure for the efficient devolution of the financial resources. The whole phase of financial devolution has experienced various experiments for resource sharing models such as: transfer of resources from the Provinces to the Centre (under the Government of India Act, 1919) and again reverting back to the transfer of resources from the federal level to the Provincial level (under the Government of India Act, 1935). Further, the analysis also portrayed that this process of evolution was neither a result of the lone colonial initiatives nor a purely indigenous product but was a consequence of the natural state of affairs. And in that natural state of affairs, the country like India which is full of diversities and spread almost over a subcontinent, could not be ruled or governed by a unitary government system in an economic and efficient manner.

Additionally, in the beginning, all the efforts of the colonial rulers were to anyhow decrease the mounting fiscal deficit of the Imperial Government, but that beginning of decentralisation later on proved to be an unstoppable process which finally culminated into a well-structured Fiscal Federalism. But the structure which evolved during the colonial rule was neither aimed at the development of India nor directed to the welfare of the masses of India (Tomlinson 2008: 1-3). On the other hand, the structure of fiscal sharing was devoted to extracting as much as possible wealth of India and transfers it to the British government of that time. Moreover, the expenditure of colonial rule in India was confined to the areas and items which were necessary to maintain the peaceful hold of the colonial rule over India and also to keep the subjugation of her people intact. Thus, all these efforts for fiscal devolution were unavoidable compulsion of colonial rule in India and the last major effort i.e. the Act of 1935 became the foundation stone for the provisions of Fiscal Federalism under the present Constitution of India.

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*Ph.D. Candidate at Faculty of Law, University of Delhi, India; Email: rajeshkumar@law.du.ac.in; nandalrajeshkumar@gmail.com

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