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AGRICULTURAL TAXATION & ECONOMIC DEVELOPMENT IN INDIA :

A STUDY OF THE POTENTIAL OF AN AGRICUL-

TURAL INCOME TAX IN FINANCING

THE PLANS

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**AGRICULTURAL TAXATION & ECONOMIC DEVELOPMENT IN INDIA :**

**A Study of the Potential of An Agricultural Income Tax in Financing the Plans.**

## INTRODUCTION

Economic planning is undertaken in the belief that development can be brought about or accelerated by government intervention. Referring to the countries of South Asia, Myrdal (29, p. 715) points out that these countries have long remained in a state of relative stagnation, and that "a strong impetus is needed to end such an economic stalemate." He also feels that economic progress in the countries of South Asia is not likely to come by spontaneously, and therefore, they need "large scale state intervention coordinated in a plan."

India is the biggest of all the less developed countries. with more than 540 million people, most of whom live in desperate economic conditions. The magnitude of her problems is large, hence there is a need for large-scale economic planning. The late Prime Minister of India, Jawahar Lal Nehru once pronounced, "We are not going to spend the next hundred years in arriving gradually, step by step, at that stage of development which the developed countries have reached today. Our pace and tempo of progress has to be much faster." For rapid economic growth, however, there is a need for effective planning, which in turn calls for a large-scale mobilization of resources.

Mellor (28a, pp. 82-83) classifies the sources of capital formation for economic development into three broad categories: domestic savings, foreign aid, and, foreign private investment. Referring to the less-developed countries, he argues that the burden of domestic savings and capital formation falls largely on the agricultural sector. There is ample evidence available on the role of agriculture in the economic development of



various countries. Especially in the initial stages of industrial development of the U.S. and Japan, and more recently in the economic development of Taiwan, capital transfer from the farm sector had played a crucial role. Looking at the smallness of the industrial sector in India, agricultural sector has to bear a major responsibility in financing the plans for economic development.

The purpose of this paper is to examine the contribution of agricultural sector in financing the Indian plans since 1951. The underlying assumptions in this paper are :

(a) that additional taxation, particularly on the farm sector is the most important source of capital formation,

(b) that the basis of additional taxes should be income rather than land or consumption, and

(c) that the Green Revolution in India has resulted in enormous increases in the income of rich farmers, hence there is a need for fundamental change in the prevalent agricultural tax policy.

In Section I an analysis of the contribution of agriculture in the economic development of Japan and Taiwan has been presented. Section II presents an analysis of the relative contribution of various sources of capital formation in India, with a focus on the plan finances. A case for additional taxation as the principal source of plan-finance has been developed in this section.

Section III provides a detailed description of the relative tax-burden on the agricultural and non-agricultural sectors in India since 1951, and attempts to support a widely held view that since the inception of five year plans in India, the agricultural sector has remained under-taxed. Indian as well as foreign experts have shown serious concern over such a discrepancy between the farm and non-farm sectors, and have from time to time suggested

various measures for raising more revenue from the farm sector. A critical evaluation of these proposals has been presented in Section IV.

It is believed that in recent years the yield per acre and the average income per farm household have shown substantial increases, but most of these benefits have gone to the rich farmers, while the poor and landless farmers have not gained at all. Such an increased gap between the two classes of farmers has both political and economic repercussions, and therefore, calls for an immediate change in the tax policy with respect to the rich land owners. In Section V, we have analysed the impact of Green Revolution on the income of farmers and have compared it with the incidence of direct taxes paid by them. Taking Punjab as our case study, we have tried to estimate the potential of agricultural income tax under the Central Tax law. Finally, similar estimates have been made with respect to the country as a whole.

1

#### ROLE OF AGRICULTURAL TAXATION : AN INTERNATIONAL PERSPECTIVE-JAPAN & TAIWAN

In the context of economic development and the role of agricultural taxation, Japanese and Taiwanese experience is cited as an example for other less developed countries. Gandhi (12, P.166) contends that the pre-Meiji Japan and the pre-Independence India had remarkable similarity. Like pre-1947 India, Japan was predominantly an agricultural country until 1880, with small holdings, low productivity and extremely unequal distribution of land. Still, the spectacular way in which Japan has emerged as a high-ranking industrial nation within seven or eight decades, can be considered as a big feat of

achievement. However, throughout this process of industrialisation, agriculture has been a major source of investment for the non agricultural sector. (22, p.135).

A similar, though less spectacular economic growth has been recorded by Taiwan. In the present section, an attempt has been made to focus on the role of agricultural taxation in the economic development of these two countries with an assumption that despite the prevalent differences in socio-political structure, India can derive some useful lessons from their experiences.

#### AGRICULTURAL TAXATION & ECONOMIC DEVELOPMENT IN JAPAN

Within four decades following 1880, the Japanese national income increased by 75%, while the growth in farm output and productivity per farm worker was 77% and 106% respectively. (32, p.47) . Such a remarkable progress was mainly a result of mass-scale application of improved technology, including a liberal use of fertilizers, improved rice-strains and improvements in water management. Economic historians regard the period 1880-1920 as the most significant phase of Japan's economic development. This period was characterized by a heavy land-tax, rising tenant-farming and replacement of feudal levies-in-kind by a tax payable in money. Ohkawa and Rosovsky present a detailed, but impressive record of the Japanese economic development and contribution of agricultural taxation thereto. Land tax provided nearly two-third of the total tax revenue until the turn of the last century, and until World War I, the burden of tax on the farmer was twice as much as a non-farmer. (Table 1). Ranis (36, p.444) states that a severely repressive tax structure

TABLE I

PROPORTION OF AGRICULTURAL TAXES TO THE TOTAL TAX REVENUE AND TO THE GNP IN JAPAN  
(1882 to 1917)  
(percent)

Yearly Period (average)	Land Tax as a proportion of total tax revenue	Land Tax as a proportion of GNP originat- ing in agric- ulture	Direct Tax on non-agriculture sector as a pro- portion of GNP
1882-1892	85.6	15.5	2.3
1893-1897	80.4	12.4	2.0
1898-1902	63.2	12.1	3.2
1903-1907	55.8	11.2	5.4
1908-1912	42.8	12.5	6.4
1913-1917	37.6	12.9	4.5

Source: Kazushi Ohkawa and Henry Rosovsky : The Role of Agriculture in Modern Japanese Economic Development, in C.Eicher & L.W. Witt : Agriculture in Economic Development (McGraw Hill Book Company, New York, 1964) p.63

coupled with favourable savings propensities among the upper income groups served to siphon off, for the purpose of development, much of the increment in farm incomes. He further argues that the Japanese peasant has traditionally carried a higher incidence of tax than the non-agriculturist. Prior to the beginning of the Meiji era (1878), the peasant had to support the feudal ruling class in court cities, while after the Meiji Restoration, he was made a prime source of development capital. (36, p.448)

It has been mentioned above that during 1880-1920 the Japanese farm output and labor productivity on the farm had increased enormously, yet the farmers were not allowed to raise their standard of living, and most of their incremental earnings were taxed away. Moreover, as against this heavy drain on the farm sector, the inflow of capital into this sector was not significant. Even the governmental subsidies were not available to the farmers until 1910. During 1913-17 they received about 1% of the total subsidies provided by the government, while the proportion of land tax was still 20 per cent of the total tax revenue. (32, p.64).

Gandhi maintains that the success of Japanese agricultural tax policy indicates that a slack existed in the farm sector prior to 1880, and that without heavy taxation, increased incomes would have been consumed "as is happening in India due to high propensity to consume." He further argues that land tax in Japan not only checked the dissipation of the slack into consumption, but it also commercialized agriculture, and brought it into the orbit of money economy. (12, p.170). James Cutt (5, p.164) endorses this opinion, but adds that any radical change in agricultural tax policy on the Japanese lines will be politically unacceptable and administratively difficult in the Indian context.

Khusro and Gulati (20 and 15) join with Gandhi and argue that tax reforms in India on the Japanese lines may not only provide additional revenue to the exchequer, but are also likely to distribute the incidence of tax more equitably. A detailed description of their proposals has been presented in Section IV.

TAIWANESE AGRICULTURAL TAX POLICY & ECONOMIC DEVELOPMENT :

Taiwan provides a relatively recent example with respect to the contribution of agricultural sector in the overall economic development. The country was under the Japanese regime until the World War II, and throughout the colonial rule, she had to bear a system of "agricultural squeeze." However, after the World War II, under the new land reform policy, the government taxation and levies by means of both direct and hidden methods have been considerably stepped up, though the rates of tax on the farmer are still lower than before.

Japanese rulers did squeeze the farm sector, yet the colonial rule introduced new agricultural practices, and helped the farmers raise the yields and their income. Taiwan experienced "Agricultural Transformation" during 1926-1930, and heavy investment in irrigation and new inputs were initiated during this short span of time. However, the process of capital formation was within the agricultural sector, and neither the government, nor the non-agricultural sector was of much help to the farmer throughout the Agricultural Transformation. Contrarily, the terms of trade have since been unfavorable for the agricultural sector. Lee (23, pp.241-242) has testified that during the past forty years, Taiwanese agriculture has not only provided investible

TABLE 11

## LAND TAXES AS A RATIO TO TOTAL TAX REVENUE IN TAIWAN (1903-1943 )

Year	Per cent
1903	24.1
1904	34.7
1905	38.9
1918	30.9
1919	28.3
1934	24.5
1935	27.6
1943	6.5

Source : Teng hui Lee, "Intersectoral Capital Flows in the Economic Dev. of Taiwan, 1895-1960," 1968 (Unpublished Thesis at the Cornell University, Ithaca, N.Y.)

funds to the non-agricultural sector through intersectoral outflows and maintenance of low prices for the farm product, it has also contributed substantially to the overall tax revenue. The outflow of capital from the farm sector (annual average) increased from T\$ 14 million in 1896-1900 to T\$ 950 million in 1956-60.

Turning to the contribution of land taxes, Lee points out that until the beginning of World War II, their proportion to the total tax revenue was about 28 per cent, but declined sharply during the War. (Table II). It is evident from Table II that the agricultural sector had to bear a very high burden of tax since the beginning of the present century. In addition to the land taxes, government procurement, barter exchange and other collections on long-term loan at low prices also implied a net drain on the farm sector.

While comparing the per capita direct tax on the agricultural and non-agricultural sectors, Lee argues that until 1930 per capita direct tax as a proportion of gross domestic product was higher for the former. Even after the World War II, the farmer had to pay higher taxes than his counterpart in the non-agricultural sector. Yet surprisingly, these policies had very virtually no disincentive effect on the Taiwanese farmers. Rather, higher rates of taxation provided them a strong inducement to them for hard work and more restraint in regard to consumption expenditure. The impressive record of their productivity, saving and investment can be seen in Table III. Details on their tax burden in the recent years are not available, still, it is apparent from Table III that even the most repressive land taxes of earlier decades in the present century could not dissuade the farmers from saving and investing more and from raising the overall production. Lee has a feeling that this was all a result of an enlightened and rational rural leadership in Taiwan. (23, p. 43)



TABLE III

PATTERN OF PER CAPITA PRODUCTIVITY, CONSUMPTION, SAVINGS & INVESTMENT  
IN TAIWAN, 1920-60

Year	Index Numbers (Base year 1911)			
	Agricultural Productivity per worker	Consumption per capita	Savings per capita	Investment per capita
1920	110.3	102.4	111.5	134.7
1930	165.4	144.9	196.2	308.0
1940	185.8	155.3	384.6	408.0
1950	178.2	162.7	480.8	466.7
1960	246.8	156.0	884.6	874.7

Source: Teng-hui Lee op. cit.

Thus in Japan as well as in Taiwan massive outflow of investible capital from agriculture contributed substantially to the economic development of these two nations. The fact that agricultural productivity increased despite the prevalence of heavy land taxes clearly indicates that there did exist a slack in the farm sector and such tax policy channelled the incremental farm incomes in a proper way. However, whether such a slack prevails in India or not is an empirical issue. No comprehensive study has so far been made to ascertain the potential income in the agricultural sector. Yet, some evidence is available to prove that as compared to the non-agricultural sector, the farm sector in India has not contributed adequately in the process of country's economic development. Even though nearly half the national income flows into agricultural sector and over 30 per cent of the expenditure under the five year plans has been incurred on this sector, the rural savings have remained more or less stagnant. Besides, as we have demonstrated below, unlike Japan and Taiwan, the tax burden on the Indian farmer has also declined considerably in recent years.

Following section provides a description of the process of capital formation in India during the past 18 years of planning, and examines the past role and prospects of the various sources of plan-finance.

ECONOMIC DEVELOPMENT & CAPITAL FORMATION IN INDIA :

The process of economic development requires an increased rate of capital formation. The latter, however, implies that the society does not apply the whole of its current productive activity to the needs and desires of immediate consumption, but directs part of it to the generation of additional capital stock. The rate of capital formation, therefore, determines the rate at which a country will attain economic growth. Meier & Baldwin (28, p.338) are of the view that the accumulation of capital in the under-developed countries involves three independent activities : (i) an increase in the volume of savings so that resources that would have been used for consumption purposes can be released for other (productive) purposes, (ii) a finance and credit mechanism so that these resources can be claimed for investment, and (iii) the act of investment itself so that the resources are used for the production of capital goods.

Ragnar Nurkse (30, p.4-5) recognizes the crucial importance of capital formation in the process of economic development but adds that in the under developed countries, the whole issue should be examined in a broad perspective of supply and demand. Nurkse believes that on both sides we find a circular causal relationship in these countries. On the supply side, low levels of savings emanate from low levels of income, which is a result of low productivity. On the demand side, the inducement to invest is low because of the small purchasing power of the people which is again a result of low income and low productivity. Finally, this low level of productivity is a result of the small amount of capital used in the production process.

The significance of capital formation in the process of economic development may be demonstrated through a simple Harrod-Domar model :

$$\frac{\Delta Y}{Y_t} = \frac{I_t}{Y_t} \times \frac{O}{C} \quad (1)$$

where  $Y_t$  is the level of national income attained during the time  $t$  and  $I_t$  denotes the level of investment corresponding to that period.  $\frac{O}{C}$  is the reciprocal of capital output ratio, and  $\frac{\Delta Y}{Y_t}$  is the rate of economic growth ( $g$ ) which is apparently explained by the rate of investment and capital output ratio. Now, since at each level of income and employment, investment is equal to the savings (Keynesian identity), equation (1) can be written in the following form :

$$g = \frac{S_t}{Y_t} \times \frac{O}{C} \quad (2)$$

Thus the rate of savings is the principal determinant of the rate of economic development. More specifically, in the context of economic planning, planners have to determine a target rate of savings (and investment) such that the given rate of economic growth can be accomplished. This requires the existence or development of necessary institutions which would mobilize resources within and outside the country. Hans Singer (4), p.10 adds an important dimension to this question of ex-ante savings with the given capital-output ratio. He argues that if the population growth rate is equal to the rate of economic growth or  $g$ , even a positive rate of savings (and investment) will not break the prevalent economic stagnation. The target rate of savings should therefore, be determined on the basis of population besides the capital-output ratio and the desired rate of economic growth.

INVESTMENT AND SAVINGS IN INDIA UNDER THE PLANS :

W. Arthur Lewis had estimated in 1954 that the industrial countries were required to invest between 10 and 15 per cent of their national income to accomplish an economic growth rate of 3 to 4 per cent. Assuming that the population of India would grow at the rate of 1.5 to 1.6 per cent, Lewis suggested that for raising the standard of living by 1 per cent (and the national income by 2.5 to 3 per cent), India should invest 12 per cent of her national income. The population of India has been rising @ 2.5 per cent (linear rate of growth) since 1961, and the current rate of investment and savings should, therefore, be 18 to 20 per cent. If the domestic resources are not adequate to meet this requirement, foreign assistance has to be sought if India has to attain a targeted rate of 1 per cent growth in the per capita standard of living.

It must be made clear that if the individuals and corporations do not have adequate savings and thus fail to subscribe adequately to the process of capital formation and thereby to economic growth, the government has to come forward and make plans for development. Even for financing such "public sector plans", great reliance has to be placed in the investible funds available within the country. Since 1951 India has had three five year plans and three annual plans (1966-69) and currently the Fourth Five Year Plan is in process. In the following pages we shall examine the mode in which these plans have been financed. For convenience, the sources of plan-finance have been classified into four major groups : (1) Domestic Savings, (2) External Aid, (3) Additional taxation, and (4) Deficit financing.

We shall now review the pattern of behavior of these sources during the past three five year plans and the expected contribution of each during the Fourth Plan.

I. PATTERN OF DOMESTIC SAVINGS :

According to a U.N. classification (43) net domestic savings (Sd) in a country should be calculated on the following basis :

$$S_d = S_t - D - S_f \quad (3)$$

where  $S_t$  stands for total savings (Gross national product - consumption),  $D$  is for depreciation and  $S_f$  denotes the net inflow of foreign capital during a given year. In the developed nations, the proportion of  $S_d$  to the GNP had been over 19 per cent throughout 1950s, but in most of the less developed countries, including India, this ratio was below 8 per cent. (43, Tables).

Within the domestic economy, savings are conducted by a myriad of persons and institutions. For simplicity, they can be classified into three broad categories : (a) government, (b) households, and (c) corporate sector. Saving behavior within each category is molded by factors that are frequently different from those affecting other groups. However, as we have argued earlier, the combined savings of all groups must correspond to the targeted rate of economic growth.

The pattern of savings by these three groups during the past eighteen years has been presented in Tables IV and V. It is evident from these data that for the 1950s, i.e., during the First and Second Five Year Plans, the proportion of domestic savings to the national income increased from 6.6 per cent to 9.7 per cent, but it declined to 8 per cent in 1967-68. Apparently, this decline in savings was a result of bad crops during 1965-67, and the subsequent rise in the prices, mainly of the food articles.\*

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\* Taking 1952-53 as the base year, the index numbers for the prices of all commodities increased from 135 in 1964 to 212 in 1968. During the same period, index numbers for consumer articles rose from 137 to 242. (37, 56)

TABLE IV

## RATE AND COMPOSITION OF SAVINGS IN INDIA, I AND II PLANS AND 1961-1963

(Rs. million)

S.No.	Savings and their composition	I Plan (1951-56)	II Plan (1956-61)	1961-62 & 1962-63
1.	<u>Total Savings</u> (total of 2,3 & 4) Percentage of National Income	6508 6.6	9831 8.5	12565 9.5
2.	(a) <u>Government Sector Savings</u> Percentage of Total Savings Percentage of National Income	1149 17.6 1.2	1701 17.3 1.5	3340 26.6 2.5
3.	(b) <u>Domestic Corporate Sector</u> Percentage of total savings Percentage of National Income	402 6.2 0.4	506 5.1 0.4	886 7.0 0.7
4.	(c) <u>Household Sector</u> (total of (i) & (ii)) Percentage of total savings Percentage of National Income	4957 76.2 5.0	7624 77.6 6.6	8339 66.4 6.3
	(i) <u>Rural Household Savings</u> Percentage of total savings Percentage of Household sector savings Percentage of National Income	1637 25.1 33.0 1.6	1852 18.5 24.3 1.6	1991 15.8 23.9 1.5
	(ii) <u>Urban Household Savings</u> Percentage of total savings Percentage of Household sector savings Percentage of National Income	3320 51.1 67.0 3.4	5772 58.8 57.7 5.0	6348 50.6 76.1 4.8

Source: The Reserve Bank of India Bulletin, Bombay, Reserve Bank of India, March, 1965 (estimates of savings and investment in the Indian Economy)

TABLE V

## RELATIVE SHARES OF DIFFERENT SECTORS IN DOMESTIC SAVINGS IN INDIA

Sr.No.	Sector	Share of savings as percent of National Income			
		1960-61	1967-68	1973-74	1980-81
1.	Government sector savings	1.7	0.8	3.8	6.2
2.	Corporate sector savings	0.8	1.1	1.1	1.4
3.	Household sector savings	7.2	6.1	7.7	8.9
	Total domestic savings	9.7	8.0	12.6	16.5

Source: Yojana, New Delhi, July 27, 1969, P.11



Having reviewed the overall trend in domestic savings, we shall now examine the pattern of savings in different sectors.

1.(a) Government sector savings : Government sector savings can be sub-divided into two parts : (i) balance from the current revenue, and (ii) profits of the public enterprises.

1 (a)(i) Balance from the current revenue : The state as well as the central governments in India raise revenue through taxes, levies, stamp & registration fees and other measures. After meeting their revenue expenditure (such as defence, public safety, administration, famine relief and interest on the internal and external public debt) the residual is made available for financing the plans. This is also termed as revenue surplus of the government.

Table VI presents a trend of these surpluses during the past three five year plans. It is apparent from this table that this source of plan-finance has not been dependable in the past. Rather, during the Third Five Year Plan there was a huge deficit on the revenue account of the government and as a result, part of the funds raised for plans had to be used to meet that deficit.

One obvious explanation for these dwindling surpluses is the growing deficits in the budgets of the state governments. It may be mentioned in this connection that the state governments in India are constitutionally entitled to claim a share in the tax revenue of the Central Government for their routine administration. Besides, for their development plans too they depend heavily on the Central government's support, either in the form of additional share in the tax revenue, loans or grants-in-aid. Over the past 18 years of planning, such dependence of the states on the Center has risen manifold. While the Central Government had financed 40 per cent of the total

TABLE VI

## SOURCES OF FINANCING THE FIVE-YEAR PLANS IN INDIA (Public Sector)

(Rs. Million)

S.No.	Sources of Savings	I Plan (1951-56)	II Plan (1956-61)	III Plan (1961-66)	IV Plan (1969-74)
1.	Domestic Savings (a+b+c)	<u>11,230</u> 57.9	<u>16,170</u> 34.9	<u>23,620</u> 27.7	84,672 58.8
	a. Balance from current revenue	3,240 (16.5)	110 (0.5)	-4730 (-5.2)	2,5920 (18.0)
	b. Surplus of Public enterprise	1,150 (6.5)	1,670 (3.6)	6,960 (8.1)	1,9008 (13.2)
	c. Capital Receipts (small savings, Provident fund, Public loans and misc. receipts)	6,840 (34.9)	14,390 (30.8)	21,390 (24.8)	39,744 (27.6)
2.	External Assistance	1,890 (12.1)	10,490 (22.5)	24,550 (28.5)	24,912 (17.3)
3.	Deficit Financing	3,330 (17.0)	9,540 (21.3)	11,510 (13.2)	7,344 (5.1)
4.	Additional Taxation	2,550 (13.0)	10,520 (22.3)	26,600 (30.6)	27,072 (18.8)
5.	Total Resources (1 to 4)	19,600 (100)	46,720 (100)	86,280 (100)	144,000 (100)

Source: i) Government of India: Fourth Plan Material & Financial Balances, N. Delhi (1966)  
 ii) The Reserve Bank of India Bulletin, July, 1969  
 iii) Report on Currency & Finance, 1967-68 (R.B.I.) Statement 52

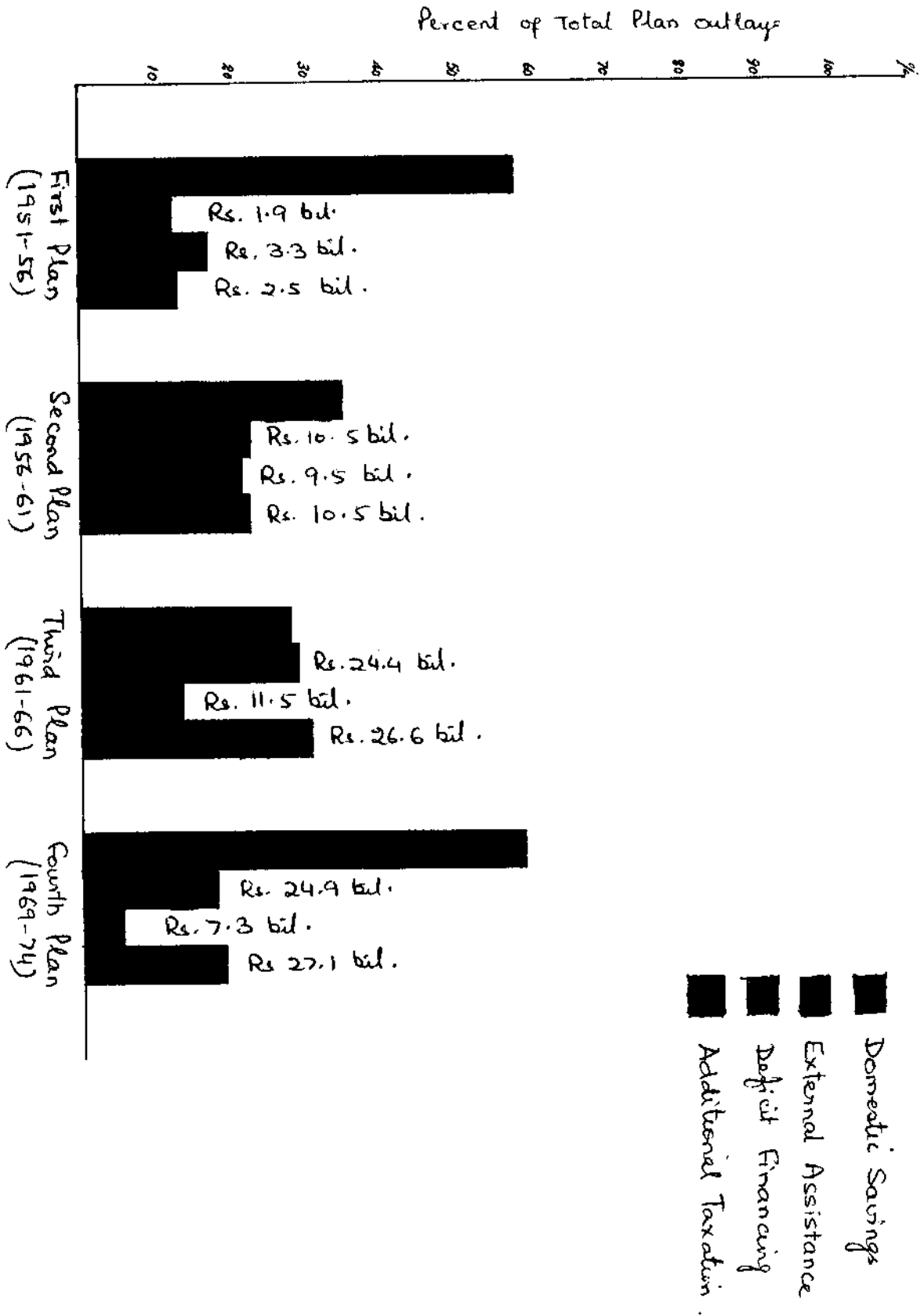
Note: Figures in parenthesis show the percentages

plan outlays of the states during the First Five Year Plan, it had to provide over 50 per cent of such outlays during the Third Five Year Plan (1961-66), and 60 per cent for the yearly plans in 1967-68. ( 39, Tables).

Indian planners hope that during the current plan (1969-74), the total revenue surpluses of the Central and state governments will provide about Rs.26 billion or 18 per cent of the total Fourth Plan outlay. This can be feasible only when the state governments reduce their reliance on the Center and mobilise their own resources. One such possible source of additional revenue is in the vast agricultural sector. But as we have demonstrated in the following section, this sector has so far been a "favored child" and on account of political maneuverings by the rich farmers, it seems highly unlikely that the state governments will raise substantial tax revenue from this sector.

1 (a) (ii) Profits of the public enterprises: During recent years a large number of industrial enterprises have been set up by the government in India, both at the Central as well as at the state levels. However, the profits of these enterprises have been of much significance so far in financing the plans. It is evident from Table VI and Chart I that until the Third Five Year Plan (1961-66), their contribution to the total plan outlays was only 8 per cent. According to a recent Reserve Bank of India report, the outstanding investment in all the public enterprises was about Rs. 45 billion on the 31st March, 1969, but they had a net profit of Rs.1 billion only during the preceding one year. (38, p.430) Indian planner's expectation that these profits will rise to an annual average of Rs. 3.8 billion during the current plan period, will remain a wishful thinking unless serious efforts are made to raise their efficiency.

Chart I : Sources of Financing the Five Year Plans in India



Thus the performance of government sector savings has not been encouraging so far and the probability of their increased contribution to the plan finance will largely depend on a number of factors such as size of the tax-base, improved administration and better organization of the state enterprises.

1.(b) Household Savings :

Household savings have provided over 70 per cent of the plan-finance during the last 18 years. Individuals save and through the purchase of Small Savings Certificates or the government bonds make available their savings to the government for financing the programs for economic development. Besides, provident fund, annuity deposits and pension funds are the involuntary savings of the government and private sector employees, and they also constitute an important source of household savings.

These savings, however, depend largely on two factors, growth rate of population and level of prices. Increase in population has a disintegrating influence on the nucleus family, and ultimately the household savings start dwindling. A reference has already been made to the impact of higher prices on savings (p. 12 footnote) in India during the past few years. Household savings have recorded a small increase mainly due to these factors. Their proportion to the national income was 5 per cent during the First Five Year Plan (1951-56) increased to 6.6 per cent during the Second Five Year Plan (1956-61) but declined to 6.1 per cent in 1967-68 (Tables IV and V).

Household savings are classified into rural household savings and urban household savings. Since the beginning of the First Five Year Plan through 1962-63 the record of the rural household savings has been much less impressive than that of the urban households. (Table IV). Surprisingly enough,

the rural households received nearly half the national income, but their savings constituted less than 16 per cent of the total savings and about a quarter of the household savings in 1961-63. Table IV also reveals that the proportion of rural savings during this period was only 1.5 per cent as against a corresponding ratio of 5 per cent for the urban households.

In a recent paper Uma Dutta (8) has estimated that the income elasticity of demand for major consumer goods in the Indian villages was 1.0062 throughout 1950s and that the marginal propensity to save (MPS) was only 0.0096. Corresponding MPS for the urban households was estimated to be 0.537. Thus, the high income elasticity of demand for the major consumer goods is a severe impediment in the growth of rural savings in India. Arun Guha (14) feels that on the basis of prevailing socio-economic structure in the country, it would not be unreasonable to assume that in the foreseeable future rural savings will not rise sufficiently, and that bulk of the domestic savings will flow from the urban households.

Yet, it will be fallacious to conclude that the rural savings can not increase because the people in the rural areas have no capacity to save. Recent studies by the Reserve Bank of India indicate that about a quarter of the rural income is received by the top 10 per cent of the big farmers. (5, pp.57-58) No dependable data are available on the use of such income, but between 25 and 30 per cent of their savings are said to be used for the purchase of precious metals, mainly gold and silver ornaments. These rich farmers have not shown enough interest in buying the government bonds or the small Savings Certificates. Efforts to mobilize savings in the rural areas should focus mainly on this elite of the agricultural community.

1.(c) Corporate savings :

Corporate sector provides less than 7 per cent of the total savings. This is primarily due to the small size of this sector in India. Desai (6, p.15) contends that most of the profits of the corporations are ploughed back for the expansion of their business operations and very small fraction is made available to the government for financing the plans. He has expressed a fear that for the next two decades to come, this sector is not likely to gain prominence in this regard. However, one important conclusion that can be derived from Tables IV and V is that since 1951 there has been a secular growth in the corporate savings, though the ratio of such savings to the national income is still about 1 per cent only.

The prospects for a swift increase in domestic savings are uncertain. However, the Fourth Plan targets for domestic savings (Table V) can be attained if population and prices can be held under control, and if the richer section of the rural community can be persuaded to part with their savings for public programs. But looking at their past performance, all this seems to be a myth, at least for the next five years. The overall contribution of domestic savings was about 58 per cent during the First Five Year Plan period, but declined to 35 per cent and 28 per cent during the subsequent two five year plans. The Fourth Plan targets for the domestic savings, therefore, appear to be highly unrealistic. (Table VI)

2. EXTERNAL ASSISTANCE :

External assistance serves two purposes in the process of economic development. In the first place, it enables the country to import capital goods and other necessary items (including food) on a long term credit basis,

and thus tends to meet the foreign exchange gap. Secondly, external capital also fills, what Ohlin calls, the savings gap prevalent in the recipient country. (33, pp.92-93). In the context of Indian plans, foreign assistance has played a very important role. (Table VI) During the First Five Year Plan (1951-56) a modest proportion of 12 per cent of the public-sector outlay was provided by the external assistance, but during the Second and Third plan period 22.5 and 28.5 percent of the plan outlays came from external agencies. The average (annual) inflow of foreign assistance during these three plans had been Rs2.5 billion, but for each successive year since 1951, the foreign aid component has shown a progressive increase. For instance, during the First Plan period the annual inflow of aid for public sector was about Rs380 million, but during the Third Plan period this average was more than Rs.4.9 billion, and for the annual plan of 1967-68 it increased further to Rs.9.9 billion. # ( 37, S 87).

However, increasing reliance on external aid by itself should not cause a panic, nor should it be regarded as an ominous facet of an economic policy. In fact, there are two aspects of this sort of plan finance which require careful consideration. In the first place, larger is the magnitude of such aid, heavier becomes the burden of debt-services or interest payment. For instance, in 1956 India had paid a modest amount of Rs. 50 million on this account, but the corresponding payment increased to Rs. 3 billion in 1968. The net inflow of foreign assistance thus declines year by year, albeit the gross receipts may show an increase.

Secondly, as Shenoy (40, p.263) puts it, Indian planners have failed

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# based on the new rate of exchange ( 1 \$ = Rs. 7.50) whereas the figures for the First through the Third plans were based on the old exchange rate ( 1 \$ = Rs. 4.76)



to utilise foreign aid for effective capital formation. He does not provide any statistical evidence to substantiate his contention, but argues on two grounds that foreign assistance has not been used/a rational way in this country. First, despite huge capital inflows from abroad, India has been harassed by acute scarcities of foreign exchange and had to draw on and deplete her currency reserves to rockbottom. Secondly, there has been very little or no improvement in the debt repayment capacity during the five year plans. Shenoy (40, pp.264-66) gives an illustration of India's export trade and argues that during the decade ending 1961-62, the national income had gone up by 43 per cent, but the increase in exports was less than 16 per cent. This, he says, is an evidence of the misdirection of foreign aid in India. \*

Thus, reliance on foreign assistance for financing the plans needs a cautious approach. Increased burden of debt-services and ineffective utilization of aid and the resultant unchanged repaying capacity may serve as serious impediments to India's long term economic development. Probably for these reasons, the Indian planners have indicated that during the Fourth Five Year Plan (1969-74) only 17.3 per cent of the plan outlays will be obtained from external sources. Moreover, the terms of aid are also being hardened by the donor countries, and we are not sure how much aid Indian planners can obtain without heavy political and economic strings. #

### 3. DEFICIT FINANCING:

The term deficit financing in the context of Indian plans does not have a connotation of a direct increase in the supply of money. Rather, it

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\* Professor Shenoy states that many of the industries set up with foreign collaboration have proven to be uneconomic and in a wide range of such industries we find idle production capacities of 40 to 50 per cent.

# For recent views on the future of aid to the LDCs, readers may see Pearson Commission's "Partners in Development, and UNCTAD's Problems & Policies of Financing (Both 1968)

implies borrowing by the government from the Reserve Bank of India, and drawing from the cash balances of the government. However, the ultimate effect of deficit financing is inflationary. It increases the overall supply of money and if the amount of goods and services does not keep pace, the country falls into an inflationary trap. Total money supply with the public in India was about Rs. 2 billion in 1951, but increased to Rs. 5.35 billion by March, 1968, and as a result, the wholesale prices (all commodities) increased by 112 per cent during 1951-68 period. (37, 57, 34 & 35). Presumably for this reason, the planners do not prefer deficit financing and resort to this device only when all other sources of plan-finance put together fail to meet the financial needs. Yet, as Table VI suggests, considerable reliance was placed on deficit financing during the past three five year plans. During the Third Plan even though the proportion of deficit financing to the total plan outlay was lower than the First Plan, yet the absolute amount of such resources was 3.5 times as much in the Third Plan. (Table VI). We are, therefore, skeptical about this claim of Indian planners that only 5 per cent of the plan outlay during the Fourth Five Year Plan (1969-74) will be obtained from this source.

Thus, increasing dependence on deficit financing is not desirable, primarily because it might push the inflationary spiral further up. It, however, leads us to the conclusion that the last source of plan-finance, i.e., additional taxation can be the only savior of Indian plans. The remainder of this paper will focus on the potentiality of additional taxation in the context of India's five year plans.

4. ADDITIONAL TAXATION :

We have argued above that the prospects of domestic savings and external assistance for financing Indian plans are uncertain, while deficit financing has inflationary implications. Additional taxation has, therefore, been accepted as a necessary evil by the Indian planners. The term "additional taxation" refers either to an increase in the rates of existing taxes or it may imply imposition of new taxes. During the First Five Year Plan (1951-56) additional taxation provided only Rs. 2550 million or 13 per cent of the plan outlay, but during the Third Plan (1961-66) Rs. 26.6 billion were raised through this device which constituted about 30.6 per cent of the plan outlay. (Table VI). A detailed account of increased tax burden has been presented in the following section. However, it should be mentioned in the present context that a number of direct taxes have been introduced during the last two decades which are based on wealth, expenditure and other indicators of one's rising prosperity. Besides, indirect taxes such as custom duties, sales tax and excise duties) have been extended to a number of new commodities. Further more, the rates of existing taxes (both direct and indirect) have been raised considerably since the inception of economic planning in 1951.

Before we start analysing the prevalent tax structure in India, it seems desirable to review the basic principles of taxation. We believe that the fiscal policy under a planned economy should be based on the following important principles : ( <sup>33a</sup> Chs. 8, 18<sub>a</sub> Chs. 8 & 18 )  
(i) Equity or Ability to pay, (ii) elasticity, (iii) economy, (iv) productivity, and, (v) sectoral balance in the incidence.

The principle of equity or ability to pay requires progression

in the rates of taxation. This can be done more conveniently with respect to direct taxes, such as taxes on income, wealth and expenditure, as compared to indirect taxes. The rates of taxation should obviously be much higher on rich persons than on the low income households. The principle of elasticity refers to an increase in the tax revenue with increased incomes. It assumes that the tax proceeds will show an autonomous increase with every increase in the income or wealth of the tax-payer. The principle of economy calls for a minimum expenditure on the process of tax collection, while productivity implies a wider coverage of a particular tax. Kaldor (19) equates productivity with an integrated tax system, under which, through a variety of taxes, the government attempts to control tax-evasion. The principle of sectoral balance in the incidence of tax suggests that the tax policy should be so designed that different sectors of the economy pay taxes in the proportion of benefits they derive from the government programs. Whether or not the Indian tax system is based on these principles is beyond the scope of this paper. Our focus will, however, be on the last principle. In the following section we shall examine the extent to which the two principal sectors in India, namely agriculture and industry have shared the increasing burden of tax during the past 18 years of economic planning.

TAXATION & ECONOMIC DEVELOPMENT IN INDIA :

As we have indicated in the previous section, taxes have become an important source of plan-finance in India. In this section we shall present a detailed account of the tax revenue in India and its significance in the context of economic development since 1951. The overall tax revenue and the surplus of tax-revenue spared for financing the plans have shown a very impressive record particularly since 1955-56. (Table VII). As this table reveals, between 1955-56 and 1965-66, the net tax revenue increased more than 6 times. A similar picture emerges when we compare the tax finances with the non-tax finances during the five year plans. (refer to Table VI).

It has been demonstrated in the previous section that bulk of the tax revenue for the plans was raised through additional taxation. Again, most of the additional taxes were borne by the non-agricultural sector, and as a result, the relative burden of tax on the agricultural sector has declined. Gulati (15 Ch.2) has estimated that during a short span of five years following 1952-53, the proportion of direct tax on the agricultural sector (as a ratio to the national income generated) increased from 5.2 per cent to 6.7 per cent, while during the same period the corresponding proportion with respect to the non-agricultural sector increased from 8.6 per cent to 11 p.c. It has been pointed out in the previous sections that taxation of agriculture is a matter of states' jurisdiction, while the Central Government is responsible to tax mainly the non-agricultural income, wealth and expenditure. For indirect taxes, most of the commodities are within the jurisdiction of the Central Government. The tax receipts of the state governments increased from Rs. 2.28 billion in 1951-52 to Rs. 8.4 billion in 1965-66. At the same time, the tax revenue of the Central Govt. increased from Rs.5 billion to 20.4

TABLE VII

CONTRIBUTION OF CURRENT AND TAX REVENUE TO DEVELOPMENT  
SPENDING IN INDIA, 1955-56 to 1965-66

(Rs. Million)

Item	1955-56	1960-61	1961-62	1962-63	1963-64	1964-65	1965-66
1. Total Tax Revenue	7676	13504	15430	18651	23246	25988	31784
2. Total Current Revenue (Tax and Non Tax)	9825	17840	19154	25020	30500	33270	37770
3. Total Non-Dev. Expend.	5854	9530	9947	14664	17600	17960	20310
4. Tax Revenue used for Development (1-3)	1822	4019	5433	3885	5534	7892	11474
5. Balance from current revenue (2-3)	3971	8310	9207	10356	12900	15310	17460
6. Tax revenue used for dev. as a % of national income	1.8	2.8	3.7	2.5	3.2	4.0	5.6
7. Balance from current revenue as a % of national income	4.0	5.9	6.2	6.7	7.5	7.7	8.5

Source : James Cutt : Taxation and Economic Development in India, 1969  
(Praeger Publishers) p.44

billion during this period. However, bulk of this increase, especially in the tax revenue of the states came from the enhanced rates of indirect taxes, such as entertainment tax, state excise duties and sales tax.

Cutt (5, 13) has estimated that between 1951-52 and 1967-68, the proportion of direct taxes to the total tax revenue declined from 36.3 per cent to 24 per cent, while the decline with respect to such taxes in states was from 47 per cent to 24 per cent. He also maintains that rising share of indirect taxes has resulted in a heavier burden on the consumers. However, the failure of state governments to raise more direct taxes (particularly from the agricultural sector) appears to be more conspicuous and leaves the vast farm sector virtually untapped for the purpose of financing their plans. The remainder of this paper will therefore, concentrate on the pattern of agricultural taxation in the context of India's five year and yearly plans.

#### AGRICULTURAL TAXES IN INDIA :

Currently there are only two direct taxes for the agricultural sector in India, land revenue and the agricultural income tax. Both taxes are levied and collected by the state governments, and therefore, their rate-structure and administration depends largely on the political and economic constraints within which a state government is supposed to function. As we have demonstrated below, the total revenue from agricultural taxes has not shown an impressive record during the past 18 years.

LAND REVENUE IN INDIA : Land revenue in its present form dates back to 1793 when the East India Company introduced "Permanent Settlement" in Bengal. Gradually two other systems, namely the ryotwari and mahalwari were also

brought forth. While cadastral survey and collection of land revenue under the Permanent Settlement areas were a responsibility of the zamidars (a group of influential rich farmers so named by the British Government), in the ryotwari areas, the government appointed revenue officials for this purpose. Mahalwari area was confined to a few small districts of the Uttar Pradesh, and land revenue was collected by a small committee of the cultivators.

Until the mid-19th century, the British Government depended mostly on the proceeds of land revenue for meeting their administrative needs. However, the proportion of land revenue declined considerably after the World War I when its collection was made a responsibility of the provinces (now called states). While until the middle of 19th century more than two thirds of the tax revenue was received in the form of land revenue, by 1911-12 its proportion declined to 31.3 per cent. By 1965-66, the proportion of land revenue to the total tax revenue of the Central and state governments declined to 4 per cent. (Table VIII)

The land revenue has, therefore, lost its significance in the tax-structure. If taken as a proportion of the national income, it was about 1 per cent in 1951-52, but declined to 0.72 per cent by 1967-68. (37, S 6 & S 98)

An Evaluation of the present land revenue policy of the state governments

Wald (43a) has classified the bases of land-taxation into four major groups : (i) tax according to area, (ii) tax based on rental value, (iii) tax on the basis of income, and (iv) special purpose tax. We shall present a brief description of the various bases used in India for land revenue.

(i) Land Tax according to area : In most of the Indian states, land tax is determined on the basis of graded-classified rates. The Revenue Department in each state keeps a record about the holdings of all the farm households, and the types of land being cultivated by them. For canal-irrigated areas, the land



tax per acre is higher in all the states as compared to the tax on dry land. Again, the rate of land revenue for inferior types of soil is very low as compared to better soils. If a household receives water from a canal or experiences a marked improvement on its land as a result of the government programs, it is required to pay a higher rate of land revenue than before.

(ii) Tax based on rental value : Until 1952, in the zamindari areas, the government would charge 10/11 of the rent received by a zamidar from the tenants. This procedure has been now replaced by graded-classified rates.

(iii) Tax on the basis of income: In Assam land revenue rates were determined on the basis of gross income (potential) per acre of land. In Madras, Uttar Pradesh and parts of Orissa, the basis was net income (potential) per acre. However, during the past two decades no revision has been made in these rates of land-tax, though output per acre (and so the gross or net income) has risen manifold. (18,p.335)

(iv) Special purpose tax : Such tax was imposed by the Moghul emperors, and was revoked with the establishment of the British Rule. No such tax exists now in any part of the country .

Recently, in most of the Indian states, the Revenue Department has started issuing pass-books to all the farmers. These pass-books contain an account of their holdings, types of land being held, and the land revenue to be paid. All the changes with respect to the title to the land (sale, gift, mortgage or succession) and all the improvements on land (irrigation or permanent improvement) have to be recorded in these pass-books.

Mathew (27,pp.124-25) feels that the land-tax per acre in India is very low, and provides no inducement to the farmer to raise productivity by using new technology, and thus impedes the growth of investment in the farm sector. He also resents the payment of land revenue strictly on the basis of ownership, for, such a provision spares even the rich tenants from a tax-liability.

TABLE VIII

LAND REVENUE AS A PROPORTION OF TOTAL TAX REVENUE IN INDIA: 1793-1954

<u>YEAR</u>	<u>PERCENT</u>
1793-94	69.0
1808-09	61.1
1818-19	73.1
1839-40	70.6
1850-51	66.5
1871-72	42.8
1881-82	35.5
1891-92	36.5
1901-02	33.9
1911-12	31.3
1938-39	16.1
1953-54	8.6
1961-62	6.5
1965-66	4.1

Source: James Cutt: Op.Cit. p.132-139

TABLE IX

## LAND REVENUE: PER CAPITA &amp; PER ACRE IN THE STATES (1959-60)

STATE	Agricultural Population (million)	Land under culti- vation (m.acres)	Per capita land (acres)	Land Revenue (Rs. m) million)	Per capita land reve- nue (Rs.)	Per Acre Land Revenue Rs.
Andhra Pradesh	17.23	32.3	1.78	113.0	6.56	3.50
Assam	8.23	5.6	0.68	25.3	3.07	4.51
Bihar	28.49	23.0	0.81	8.3	2.92	3.61
Bombay	28.34	69.5	2.45	115.0	4.06	1.65
Kerala	5.23	4.5	0.86	13.0	2.49	2.89
M.P.	19.51	40.5	2.08	97.2	4.98	2.40
Madras	15.18	16.7	1.10	49.0	3.23	2.93
Mysore	13.60	26.9	1.98	43.0	1.46	1.60
Orissa	11.30	16.1	1.43	22.4	1.98	1.39
Punjab	11.15	17.4	1.56	44.4	3.98	2.55
Rajasthan	12.71	37.3	2.93	79.4	6.25	2.13
U.P.	49.16	42.0	0.85	209.1	4.25	4.98
West Bengal	19.73	13.0	0.66	50.4	2.55	3.88

Source: Techno Eco. Survey of U.P; New Delhi, National Council of Applied Economic Research (1962) P.331

Bhargava (1, 1290-95) draws attention to the inter-state disparities in the existing land revenue rates. He argues that in the prosperous states of Punjab, M.P., Mysore and Madras, the burden of land revenue per farmer as well as per acre of cropped area is lower, while in U.P., Andhra Pradesh and Assam such burden is substantially higher despite the low level of output and productivity per acre in these states. (Table IX)

Thus the present system of land revenue violates the important principles of a good fiscal policy. Bhargava (1, p.1292) points out that over the past two decades, Indian state governments have made no effort to increase the proceeds from land revenue, even though their development expenditure has increased enormously for the agricultural sector. As a consequence, tax-burden, other than the land revenue, has continued to rise in almost all the states. (Table X).

We can derive following conclusions about the present land revenue system in India :

(a) Land revenue has lost its importance as a source of finance. Currently, it provides about 8.5 per cent of the total tax revenue of the state governments. This means that for financing their development plans, they have to depend largely on other sources, including the grants and loans from the Central Government. (Table X)

(b) It has failed to tap increased agricultural incomes. There has been very little upward revision in the rates of land tax since Independence, and whatever increase has occurred in the total proceeds is mainly due to increased area under cultivation. It may be mentioned in this context that between 1950-51 and 1967-68, the gross cropped area increased by 22 per cent. During the same period, the compound annual growth rate in agricultural

TABLE X

LAND REVENUE AND AGRICULTURAL INCOME TAX IN TOTAL  
TAX REVENUE OF INDIAN STATES  
(1951-52 to 1968-69)

PERIOD	(Rs. million)				
	Land Revenue	Agr. Income Tax	States Total Tax Revenue	Land Revenue/ Total Tax %	Agr. Income/ Total tax %
I Plan (1951-52 to 1955-56)	3267	246	12571	25.9	2.0
II Plan (1956-57 to 1960-61)	4550	425	18969	24.0	2.0
III Plan (1961-62 to 1965-66)	5703	489	33399	17.0	1.4
1966-67	896	105	4918	9.5	1.1
1967-68	960	120	10650	9.0	1.1
1968-69 (Revised)	1020	120	11570	8.8	1.0
1969-70 (Budget)	1040	120	12140	8.6	1.0

Source: (i) Reserve Bank of India: Reports on Currency & Finance (Quoted by P.K. Bhargava ~~op. cit.~~ (1))

(ii) RBI Bulletin, June, 1969 pp. 750-2.

production had been 1.5 per cent (including the two famine years of 1965-67). During this period the overall increase in the agricultural incomes was more than threefold. Contrarily, the increase in the land revenue was only 50 p.c.

(c) Even in those states where agricultural production increased at a rate higher than 4 per cent per year since 1952-53 (such as Punjab, Gujarat and Madras), the increase in the proceeds of land revenue has been less than 2 per cent per year. Needless to repeat that much of this increase was due to an increase in the cropped area along with an expansion of the irrigation facilities.\* On the other hand, in Assam and Kerala, despite a low rate of increase in the output, land revenue has shown substantial increase.

(d) With rising population and increased pressure on land, the price of land (per acre) has shown a secular increase in the recent past. In Punjab, for instance, price of cultivated land increased from Rs.851 per acre in 1951-52 to Rs. 1233 per acre in 1964-65, but the average land revenue showed only a small increase from Rs. 2.40 per acre to Rs.2.97 per acre during this period. Further, the price of land by more than 100 p.c. (to Rs. 2547 per acre) between 1964-65 and 1966-67, but the land revenue per acre could rise only to Rs. 4.15 per acre, much of which was again due to multiple cropping and increased irrigation. ( 34, and 35). Thus, the present land revenue system does not take into account the increased value<sup>of land</sup> and tax-paying capacity of the cultivator.

We can conclude, therefore, that the land revenue system in India has become obsolete, and requires drastic changes in the rates of land revenue, and also in the procedures for establishing the basis of taxation.

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\* In most of the states, rates of land revenue are higher for irrigated area as compared to the rain-fed area.

AGRICULTURAL INCOME TAX :

Agricultural income was subject to the union (British) government's tax provisions during 1860-65 and 1869-73. From 1873 to 1935, the Indian farmer had no direct tax liability other than the land revenue. However, in 1935, under the Government of India Act, provinces or the states were authorised to tax farm incomes. Until 1951 only 6 states had introduced agricultural income tax. During the First Five Year Plan (1951-56) seven more states levied such tax, but later, some of them abolished it on account of administrative difficulties. As of now only 9 states have an ag. income tax.

The total receipts from agricultural income tax have, however, been stagnant during the past decade, albeit the proceeds are currently higher than 1951-52. (Table XI ). It is evident from Table XI that this source of agricultural taxation does not satisfy the principle of elasticity. Bhargava ( 1, p.1290) maintains that although in absolute terms, the yields from agricultural income tax have increased from Rs. 246 million in the First Plan to Rs. 425 million in the Second Plan and further to Rs. 489 million during the Third Five Year Plan, the actual yield in individual states has declined. He argues that the increased receipts from this source has been primarily due to introduction of agricultural income tax in more states. He gives examples of U.P., West Bengal and Mysore where the receipts from this tax declined from Rs. 5.3 million to Rs.0.8 million, from Rs.11.7 million to Rs. 6.5 million, and from Rs. 5.4 million to Rs. 3.8 million respectively between 1957-58 and 1963-64.

Secondly, only three states, namely Assam, Kerala and Madras account for almost 70 per cent of the total receipts from ag. income tax, presumably because the tea, coffee and rubber plantations are located mainly in these

TABLE XI

## AGRICULTURAL INCOME TAX IN INDIA (Rs. Million)

<u>Year</u>	<u>Amount</u>	<u>Index No. of Agr. Production (Base 1949-50)</u>
1960-61	94.9	142.2
1961-62	94.4	144.8
1962-63	95.7	139.6
1963-64	92.6	143.1
1964-65	107.3	158.5
1965-66	98.8	132.7
1966-67	105.0	132.0
1967-68	120.0	161.8
1968-69	120.0	174.3

Source: i) Reserve Bank of India (Bombay) Reports on Currency & Finance (1961-68)

ii) Stat. Abstract: India 1968 pp. 74-75, C.S.O. New Delhi (1969)



states. Contrarily, Punjab and Gujarat, where agricultural incomes are rising more rapidly, the state governments have not introduced any agricultural income tax. In Maharashtra the income tax on farm income does not apply until an annual income of Rs. 36,000.

Over the past three years agricultural production in India has shown a sharp increase, but the receipts from agricultural income tax have stagnated since 1967-68. This has resulted in more inter-state disparities in farm incomes than before. (Table XI)

#### OVERALL BURDEN OF DIRECT TAXES ON THE FARM SECTOR

It is apparent from the preceding tables and statements that the direct tax burden on the farm sector in India has shown a declining trend. If the ratio of direct tax burden to the national income is compared between agricultural and non-agricultural sectors, this argument can further be substantiated. (Table XII). It is clear from Table XII that since 1955-56 the average tax paid by a farmer has declined year by year, while the rate of direct taxation per rupee of non-agricultural incomes has remained more or less constant. In relative terms, burden of tax on the farmer has shown a sharp decline, but the non-farmers have been required to pay higher taxes. Again, as we can see from Table XII, the combined proceeds of land revenue and agricultural income tax have only doubled during the past 19 years of planning era, while the direct taxes paid by the non-agriculturists (such as personal income tax, corporation tax and taxes on wealth and expenditure) have demonstrated more than a four-fold increase during the same period. It is also clear that the proportion of direct taxes to the income of non farmers increased from 3 per cent in 1955-56 to 5 p.c. in 1969-70, but during the same period, the corresponding ratio for the farmers declined from 1.9 per cent to 0.7 per cent.

TABLE XII

TABLE SHOWING BURDEN OF DIRECT TAXES ON AGRICULTURAL &amp; NON-AGRICULTURAL SECTORS (Rs. Million)

Year	Total Direct Taxes (Agr.)	National income in Ag. Sec.	Ratio of direct taxes to Ag. Incomes %	Total Direct taxes in Non-Ag. Sector	National income in non-Ag. Sec.	Ratio of direct taxes to non-Ag. Incomes %
1950-51	546	47800	1.14	1732	47500	3.64
1955-56	857	43900	1.90	1683	54900	3.06
1960-61	1067	67070	1.59	2884	68180	4.22
1961-62	1046	70100	1.49	3320	74030	4.48
1962-63	1296	71960	1.80	4187	80910	5.17
1963-64	1327	84730	1.56	5446	29060	5.91
1964-65	1305	101550	1.28	5939	104170	5.70
1965-66	1218	98010	1.24	5914	114270	5.17
1966-67	1001	115950	0.86	6500	125500	5.16
1967-68	1080	130000	0.83	6479	127500	5.10
1968-69	1140	150000	0.75	6728	131000	5.14
1969-70	1160	158000	0.70	7020	141000	5.01

Source: See Appendix K for Col. and \$ for Agr. and Non-Agr. Incomes. For other columns (i) Report on Currency and Finance, 1967-68, Bombay, Reserve Bank of India, (ii) Eastern Economist, Annual Number, 1970.

DIRECT OUTLAYS ON AGRICULTURAL DEVELOPMENT AND DIRECT TAX BURDEN ON THE FARMER

Another way to examine the contribution of agricultural sector to the economic development is to look at the outflow of funds from this sector in the form of direct taxes such as land revenue and agricultural income tax, and compare it with the expenditure incurred by the government for the development of agriculture. In this context we should also note that expenditure on roads, hospitals <sup>and</sup> education also provides an impetus for the development of agriculture, but the direct benefits from such outlays are difficult to measure. Further, as against such indirect benefits the farmers have to pay taxes on the consumer goods. It is worth mentioning in this context, that in the past 18 years the rates on excise duties (taxes on production) on several consumer goods, such as cotton textiles, matches and other essential items have increased considerably. However, like the imputation of indirect benefits mentioned above, measurement of the incidence of indirect taxes is also a fairly difficult job. For the purpose of this paper, therefore, we shall compare the incidence of direct taxes with the direct outlays on the development of agriculture under the five yearly and yearly plans.

Table XIII presents the total expenditure on various public sector programs for the development of agriculture since 1951\*. It also provides data on the direct taxes paid by the farmers and their elasticity with respect to the overall expenditure shown in column 2.

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\* These programs include various schemes for raising the production, flood control, irrigation, animal husbandry and agricultural research, but exclude rural electrification.

TABLE XIII

TOTAL EXPENDITURE ON AGRICULTURAL DEVELOPMENT AND DIRECT TAXES  
PAID BY THE FARMERS IN INDIA  
(1951-1968-69)

Period 1	Expenditure on Ag.Dev. (Rs.million) 2	Direct taxes paid by far- mers. (Rs.million) 3	Taxes as a proportion to total exp. (per cent) 4	Elasticity of 3 w.r.to 2 5
First Plan (1951-56)	6040	3513	58	+ 0.39
Second Plan (1956-61)	9780	4975	51	+ 0.15
Third Plan (1961-66)	17630	6192	35	- 0.20 *
1966-67	4720	1001	21	+ 0.26
1967-68	5020	1080	20	+ 0.08
1968-69	5820	1140	19	

\* This negative elasticity is due to a sharp decline in the land revenue in 1966-67 as compared to the average proceeds obtained during the Third Plan. 1965-67 had a severe drought in the northern part of the country.

Sources: Eastern Economist, Annual Number, 1969, New Delhi, for column 2.  
P.K. Bhargava (1) for column 3.

The direct outflow of funds from agriculture constituted 58 per cent and 51 per cent of the inflow through public sector schemes under the First and Second Five Year Plans respectively. However, for the subsequent plans these proportions have been discouraging. (Table XIII). In short, the contribution of farm sector for its own development has shown a sharp decline throughout this period, and unlike Taiwan and Japan, the non-agricultural sector has financed the agricultural development in India. This has been clearly a violation of the principle of sectoral balance in the distribution of tax burden in this country. From time to time, Indian as well as foreign experts have expressed serious concern over this growing discrepancy between the two sectors, and have suggested alternative policy measures, but so far no change in the tax policy has been made.

In the following section we shall, therefore, review these proposals and examine their feasibility in the Indian context.

#### IV

#### REVIEW OF THE PROPOSALS FOR AGRICULTURAL TAX REFORM IN INDIA :

Writing as far back as in 1928, Professor Gyan Chand (17, p.69) had stated that in the assessment of land revenue in different provinces there were many outrageous inequalities. He suggested that the assessment of land tax should be based on the capital value of the land. Professor Gyan Chand was critical of those who recommended the abolition of land revenue on the small holdings, and argued that such a measure "would make the agricultural tax system less productive, would encourage non productive borrowing and, drive the Indian peasantry deeper into impoverishment by providing an

artificial stimulus to the growth of population." Instead, he maintained, a progressive land tax based on the capital value would induce the owners of land to use their resources more effectively. (17, pp 79-81)

While Professor Gyan Chand's proposal for a progressive land revenue based on the capital value of land fully satisfies the principles of equity in the tax policy, it overlooks the grave administrative problems involved in its implementation. Especially in the present context, when the productivity of land and the resultant price of land are changing so rapidly that the revision of the rates of land revenue based on his scheme appears to be an impossibility.

Since the beginning of economic planning in 1951, several other schemes for agricultural tax reform in India have been suggested. We shall review these proposals in a chronological order.

#### TEC on the Agricultural Taxation :

The taxation Enquiry Commission (1953-54) conceded that there was considerable disparity in the relative tax-burden between the farm and non-farm sectors in India. The Commission recommended a two-phased revision of the land revenue system : (a) standardization of assessment in each state, and (b) revision of the assessment at reasonable time intervals. The TEC also suggested that subject to a maximum increase of 25 per cent in the existing assessment, all lands might be re-assessed on the basis of increase in the price levels since the previous assessment. However, no recommendation was made with respect to the newly settled areas, but it was expected that as dry areas turn into irrigated tracts, overall land revenue will automatically increase. (27, pp.129-131)

The TEC also gave serious thought to the policy with respect to agricultural income tax prevailing in different states. It suggested, in the first place, that this tax should have uniform provisions in all the states, and secondly, over the long run, suitable measures should be taken to merge agricultural incomes into the central income tax provisions. Thus, the TEC recommended for the introduction of uniform provisions for income-tax in all the sectors. (15, pp.74-76)

While we fully subscribe to the TEC's view that over the long run, all types of income, agricultural and non-agricultural alike, should be taxed under a common income tax-policy, to us its views on the reform of land tax policy do not seem to be at all convincing. Mathew ( 27, pp.130-31 ) observes that these views are extremely conservative and do not show sufficient awareness of the importance of mobilization of domestic resources for financing the plans. Secondly, standardization of rates by raising them on the basis of previous settlement would not free the new policy from the flaws prevalent in the previous settlement. Finally, TEC's suggestion for a maximum increase of 25 per cent in respect of the land, other than the newly settled areas, provides no basis for progression in the land revenue policy. The Commission's support for proportionality in the land-tax rates overlooks the principle of "ability to pay" in a fiscal policy. Ved Gandhi (12, p.205) feels that the TEC had under-estimated the administrative difficulties involved in the process of re-assessment after definite time-intervals. Further, he continues, these proposals did not intend to raise the revenue from agricultural taxes as an important source of finance, and, therefore, gave no suggestion for making land revenue elastic in relation to the production.

Gulati's Scheme of Progressive Land Revenue :

I.S. Gulati (15, pp.74-76) estimated in 1957-58 that the average rate of land revenue in India at that time was Rs. 2.50 per acre. Considering this to be "regressive and unfair", he presented a scheme for progressive land-tax policy for the country as a whole. Table XIV demonstrates the rate-schedule designed by Gulati under his Scheme. As this table suggests, Gulati intended to retain the land revenue on the first 20 acres of holdings at its existing level, while on the subsequent sizes of holdings, he wanted an element of progression to be introduced. Gulati claimed that this Scheme would bring an additional land revenue of Rs. 612 million to the state governments, 55 per cent of which would come from those farmers who owned over 100 acres of land. Recently, he has reiterated his demand for progression in the rates of land-revenue. (16) He claims that despite such progression, there will not be any disincentive effect on the farmers, because the tax-burden on him will still be lower than the non-farmers. For instance, a farmer with 70 acres of land and an annual income of Rs.10,000, under his Scheme, would pay 5.75 per cent of his income as land-tax, while a non-farmer with an equivalent income has to pay over 10 per cent of his income as tax.

Gulati's Scheme suffers from many weaknesses. In the first place, size of land-holding is a poor index of a farmer's ability to pay a tax. Farm management studies in different states demonstrate that the quality and productivity of land per acre are inversely related to the size of land-holdings. Secondly, progression in land revenue based on the size of holdings has a danger of encouraging subdivision of land, at least among the members of the same family and might thus lead to serious problem of tax-evasion.



TABLE XIV

## GULATI'S RATE-SCHEDULE FOR PROGRESSIVE LAND REVENUE IN INDIA

Area of household holding	Rate of land revenue Rupees per acre
First 20 acres	2.50
next 10 acres	5.00
next 10 acres	7.50
next 10 acres	10.00
next 50 acres	15.00
over the balance of land holding...	25.00

Source : I.S. Gulati, Resource Prospects of the Third Five Year Plan, 1960,  
Bombay, Orient Longmans, p.76

Finally, even such progression leaves out the prospective changes in the productivity of land and income of the farmers, because his Scheme provides a revision of the existing rates of land revenue only. Mathew (27, pp.133-34) argues that Gulati's Scheme takes no account of the yield potential of each holding which depends on the nature of the soil, climatic conditions, and availability of irrigation facilities.

KHUSRO'S SCHEME OF PROGRESSIVE LAND TAXATION :

In early 1963, A.M. Khusro (20) proposed his Scheme for a progression which is similar to the one presented by Gulati in 1958. However, Khusro recommended that upward revision in the rates of land revenue should start with all the holdings that are above 5 acres in area. He argued that the farmers with 5 acres or less should not be called upon to pay any additional tax "on the grounds of equity and justice." For the holdings between 5 and 10 acres, Khusro suggested a revision of land tax from the existing rate of Rs. 3 per acre to Rs. 5 per acre, while for all the holdings above 10 acres, he suggested a land-tax rate of Rs. 10 per acre.

Khusro claimed that since 75 per cent of the farm households in India have less than 5 acres of land, his scheme would not hurt them at all. However, he added, an upward revision in the rates of land tax for the rest of the farm-households would bring an additional revenue of Rs.2,000 billion to the state governments. Yet, he gave a note of caution that the grading of land must be in terms of standard rather than simple acreage.\*

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\* Standard acreage considers productive capacity of the land, and thus differentiates irrigated land from un-irrigated and more fertile from the less fertile land.

In a recent paper, Khusro brought forth a major change in his earlier scheme. (21) He has now suggested that all the farmers who have less than 5 acres of land should be exempted altogether from the land revenue. For those having above 5 acres of holdings, he has prescribed an increase between 25 and 50 per cent in the rates of land-tax.

Khusro's scheme also suffers from lack of farsightedness. In fact, his proposed revision of the rates of land revenue implies a "once for all" tax reform, which is suitable only for the short run. Moreover, exemption of all the farmers having less than 5 acres of land will induce the medium farmers to subdivide their holdings, and will ultimately result in heavy loss of revenue to the state governments.

OTHER PROPOSALS FOR AGRICULTURAL TAX REFORM IN INDIA ; (27 pp.134-37)

Groves and Murugappa proposed a blanket increase of 10 to 30 per cent in the rates of land revenue for area under foodgrains, and 100 per cent increase in respect of land under commercial crops. However, they did not provide details of their scheme. It seems, a blanket increase in the rates of land revenue was suggested by them with a view to increasing the government revenue from this source. But such a measure cannot relieve the present system of land - taxation of its regressive and inelastic features. Kaldor recommended that the land tax policy should be progressive and therefore, the rates of tax should be based on "potential output." He defined potential output as the volume which the given land-holding will produce if it were managed with average efficiency. This suggestion is unacceptable, because the term average efficiency is vague. K.N. Raj suggested imposition of a tax on the agricultural rent and a surcharge on commercial crops. In the first

place, under Indian conditions, it is very difficult to identify the rent payer and therefore, assessment and collection of a tax on rent would not be feasible. Secondly, a surcharge on the commercial crops would mean a discrimination against such crops, and may have a disincentive effect on the farmers growing them.

VED P. GANDHI'S PROPOSAL FOR INCOME TAX ON AGRICULTURAL INCOMES :

All the proposals discussed above dealt with the existing land revenue policy only. Ved Gandhi (12, and 13) took a different approach and suggested that tax on the farmer should be based on his income, rather than land-holding. Gandhi argues that during the recent years farm income has shown a considerable increase, but the farmers' tax-burden has declined. He has recommended the inclusion of agricultural incomes also under the provisions of Central Income Tax Law.

Such a change in the agricultural tax policy, as Gandhi puts it, is likely to bring in an element of equity in the Indian tax structure. Besides, this would also introduce elasticity in the tax policy and restore sectoral balance in the incidence of tax. He feels that linkage of farm incomes with progressive Central Income Tax rules will provide an inducement to the farmers to work more efficiently.

We endorse Ved Gandhi's approach and hope that this device will not only bring forth more revenue to the government for financing plans, but will also introduce a dynamism in the agricultural tax policy in India. In the following section, we have demonstrated the potential of agricultural income tax policy under the Central Income Tax rules, first with respect to Punjab, and then the entire country.

GREEN REVOLUTION AND POTENTIAL OF AGRICULTURAL INCOME TAX (CENTRAL)

An attempt has been made in this section to measure the potential of agricultural income tax, if introduced under the administration of the Central Government. As we have noted below, there has been tremendous increase in the income of the farmers during the recent few years. Yields per acre and the overall income of the farm households have shown a steep rise in these years. However, the impact of the Green Revolution is more apparent in Punjab than elsewhere. We have, therefore, taken the state of Punjab as a case study and have estimated the potential of agricultural income tax in 1967-68, as compared to the actual revenue received by the government as land revenue during that year. Similar estimates have then been made for the entire country.

Green Revolution in Punjab & Agricultural taxation :

Indian as well as foreign experts agree that over the past six or seven years, the Punjab has attained the highest rate of growth in the production of foodgrains in India. There are differences of opinion, however, on the issue of the distribution of the gains from the increased production. An excellent account of the "Green Revolution" in Punjab has been presented by Wolf Ladejinsky in a recent paper (24). While commending the overall agricultural development in Punjab, Ladejinsky feels that regardless of whether an observer probes deeply or even so lightly into the Punjab scene, "the signal impression he is bound to carry away is one of the air of prosperity that permeates the state." By 1969, nearly 80 per cent of the area under wheat and almost 50 per cent of the cropped area in Punjab had been brought under the high-yielding varieties of foodgrains. Besides, within six years following 1962-63, the consumption of fertilizers

In the state increased six times. According to a recent report of the State Government of Punjab, the output of foodgrains in Punjab rose at a linear rate of 6.5 per cent during 1963-69 period. Besides, various irrigation projects have increased the proportion of irrigated area to 70 per cent of the cropped area in 1968-69. The crop intensity index has risen from 1.2 to 1.4 during the past six years. (11)

Table XV presents a trend in the yields of rice and wheat in the Punjab as compared to the average yields obtained in India since 1963-64. The Government of Punjab claims that besides wheat and rice, the area under sorghum, millets and maize has also increased greatly since 1963-64. (11) Ladejinsky expresses a note of optimism by stating that an average farmer in Punjab is today conscious of his new role, a role of investing and experimenting with new varieties and better techniques, and

Thus the impact of Green Revolution is apparently more conspicuous in Punjab than in the other states. But as against this increasing prosperity among the farmers of Punjab, their average burden of tax is declining. Surprisingly enough, the State Government has made no effort in the past to bring forth even the slightest upward revision in the rates of land revenue. Of course, the average land revenue per acre has shown an increase in the past, but as we have mentioned above, this is merely a result of increased irrigation facilities. It seems ironical that in a state such as Punjab, so far no effort has been made to introduce the agricultural income tax, and the only direct tax for a farmer is land revenue. Still more surprisingly, the incidence of land revenue per acre is declining. (Table XVI)

TABLE XV

## AVERAGE YIELD OF WHEAT AND RICE IN PUNJAB AND INDIA, 1963-68

(yield per hectare in kilograms)

Year	W H E A T		R I C E	
	Punjab	India	Punjab	India
1963-64	1256	730	1097	1033
1964-65	1510	913	1223	1073
1965-66	1238	824	1000	869
1966-67	1524	878	1185	865
1967-68	1863	1111	1322	1031

Source : Yojana, New Delhi, January 26, 1970

TABLE XVI

CROPPED AREA AND TREND IN LAND REVENUE IN PUNJAB  
for 1959-60, 1963, 1967-68 and 1968-69

Year	Net sown area (million acres)	Gross cropped area (million acres)	Land Revenue (Rs. million)	Land Revenue per acre of net-sown area (Rs.)	Land Revenue per acre of gross cropped area (Rs.)
1959-60	3.6	4.3	18.0	5.0	4.2
1963-64	3.8	4.8	19.0	5.0	4.0
1967-68	3.8	5.0	18.5	4.7	3.7
1968-69 (Revised)..	3.9	5.4	19.6	5.0	3.6

Sources : (i) Statistical Abstracts of India, C.S.O., New Delhi, for 1961, 1963, 1967 and 1968.

(ii) The Reserve Bank of India Bulletins, June (1962, 1968 & 1969)

(iii) The Economic Times, Bombay, August 17, 1970



S. Chandrasekhar has estimated the incidence of various (major) taxes in different states of India. (4). He contends that in most of the states, overall burden of tax per capita has shown an abrupt increase between 1960-61 and 1965-66, but the incidence of land revenue has declined. His estimates for Punjab have been presented in Table XVII. However, for updating the incidence of per capita tax in Punjab, data for 1968-69 have also been added.

It is evident from Table XVII that the State Government has preferred to impose heavier burden of tax on the non-agricultural sector, and has effected substantial increases in the sales tax, excise duties and taxes on urban property. There has been a marked increase in the stamp and registration fees, but their overall contribution to the state's tax revenue is not very significant. It seems, however, the powerful farmer's lobby in the Punjab Legislative Assembly has so far been successful in avoiding any type of increase in the direct taxes which might affect their interests adversely. Green Revolution has certainly benefited the agricultural sector in Punjab, but as the evidence so far goes, large farmers have been the recipient of a greater share of this growing prosperity.

Wolf Ladejinsky maintains that only about 20 per cent of the farmers in Punjab have been the real beneficiaries of increased yield under the Green Revolution, and are 'making money hand over fist.' He estimates that only 15 per cent of the small farmers have adopted new varieties of wheat and other high-yielding foodgrains. (24) However, the reluctance of the State Government to raise the rates of taxation for the large farmers has, widened the gap between the rich and poor farm-households in Punjab. Secondly, it has also deprived the state treasury of additional resources for financing the development plans. A rationally designed tax policy would have yielded

TABLE XVII

## PER CAPITA TAX IN PUNJAB FOR 1960-61, 1965-66 and 1968-69

( Amount in Rupees )

Type of tax (average per capita)	1960-61	1965-66	1968-69
1. All state taxes	13.03	23.68	45.50
2. Land Revenue	2.16	1.42	1.40
3. Sales Tax	3.39	7.63	10.50
4. Percentage of land revenue per capita to Income per capita...	0.60	0.32	0.23

Sources : (i) S. Chandrasekhar, "Interstate Disparities of Tax-incidence in India," in Economic & Political Weekly, Bombay, June 4, 1968.

(ii) Reserve Bank of India Bulletins (May and June, 1969) for 1968-69.

additional revenue and would also have redressed the prevalent inequity in the distribution of gains from the Green Revolution. In the following pages we have presented farm income estimates in Punjab for the year 1967-68, and have examined the implications of an income tax policy for the large farmers.

FARM INCOME ESTIMATES IN PUNJAB AND POTENTIAL OF INCOME TAX ON LARGE FARMERS

No data are available on the estimated income of farm households in Punjab. However, estimates of farm income in India have been made by Madalgi (25) and may be used for Punjab after adjusting them for yield differentials. Madalgi observes that since the First Five Year Plan (1951) there has been an enormous increase in the farm income (net of production costs) in India. But the average income of large farmers has more than trebled while the increase in respect of small farmers has been only 30 per cent during the past 18 years of planning era. (Appendix D)

In order to measure the potential of income tax on the large farmers, we have adjusted Madalgi's estimates of farm income in India according to the differences in the average yield per acre. Earlier, we have mentioned that the yields in Punjab in 1967-68 were approximately 30 per cent higher than the all India average. Assuming that these yield differentials are evenly distributed among all the categories of farm-households, an adjustment co-efficient of 1.3 has been used for estimating the farm income in Punjab. (Table

Once the estimates of farm income for different categories of households are obtained, measurement of their income tax-liability under the Central Income Tax law would pose no problem. As Table XVIII indicates, this device would have required large farmers to part with 7 per cent of their

XVII

TABLE XVIII

## POTENTIAL OF AGRICULTURAL INCOME TAX (CENTRAL) IN PUNJAB, 1967-68

Size of holding per household (acres)	Number of households (thousand)	All India Average income per household (Rs.)	Average income per household in Punjab (Rs.)	Income tax payable per household (Punjab) Rs.	Total potential of income tax (Rs.million)
below 5	660	684	889.20	Nil	Nil
5-10	330	1713	2227.00	Nil	Nil
10-50	480	6711	8724.30	632.43	303.57
above 50	30	22738	29549.40	5819.60	174.59
				TOTAL	478.16

Sources : (i) National Sample Survey. Report on Land Holdings (8th Round-1954-55) 1960, The Cabinet Secretariat, New Delhi.

(ii) S.S. Madalgi (25)

(iii) James Cutt, (5) p. 86 (for rates of income tax)

(iv) Reserve Bank of India Bulletin, June, 1969

net income, while the largest farmers would have paid less than 20 per cent of their net incomes as income tax. Yet, the government could have collected about Rs. 480 million as against Rs.18.5 million obtained from land revenue in 1967-68. That the income tax on large farmers is progressive, and is based on the principle of equity is clear from the following statement :

Statement showing comparative incidence of income tax and land revenue (PUNJAB)

Size of holding (Acres)	Mean holding (acres)	Av. Income Rs.	Av. land Rev. per h.h. (Rs.) @ Rs. 5/acre x	Av. income tax per h.h. Rs. Y	Ratio of land Rev. to income tax Y/x
below 5	2.5	889.20	12.50	Nil	--
5-10	7.5	2227.00	37.50	Nil	--
10-50	30.0	8724.30	150.00	632.43	4.2
50 +	75.0	29549.40	375.00	5819.60	15.5

It can, therefore, be concluded that the introduction of income tax for the agricultural sector in Punjab would have served a dual purpose of providing additional resources to the government, and also, of bringing in an equitable distribution of the gains from Green Revolution.

ESTIMATES OF NATIONAL ADDITIONAL TAX RESOURCES BASED ON THE AG. INCOME TAX

It has been demonstrated above that the introduction of income tax on farm incomes (based on the Central Income Tax law) could have yielded more than 25 times as much revenue as compared to the proceeds of land revenue in Punjab in 1967-68. Similar estimates for the entire country can now be made on the basis of farm income estimates released by Madalgi (25). However, it seems appropriate to examine the incidence of land revenue on different categories of farmers relative to their net income during the planning era.

It is evident from Table XIX that the burden of land revenue on small and medium farmers increased until the Third Five Year Plan (1961-66) but then it dropped to the level prevalent during the First Five Year Plan. In other words, these households had to pay the same proportion of their income as land revenue in 1967-68 as during the First Plan. On the contrary, the incidence of land revenue on the large farmers (having above 10 acres of land) has declined throughout this period (1951-68). (Table XIX) The regressive nature of land revenue is apparent from the fact that in 1967-68 ; the small farmers had to pay higher proportion of their income as land revenue than the large and very large farmers. All these facts explain the built in inelastic nature of land revenue. If farm incomes were taxed under the central income tax, it would have not only given additional revenue to the planners, but it would have also restored justice in the tax policy..

Our estimates of the additional tax resources from agricultural income tax have been presented in Table XX. Assuming that the number of farm households has increased in the same proportion in which population has increased since 1961, there should have been 76.6 million farm-households in India in 1967-68. The pattern of land distribution among the different categories of households has been obtained from N.S.S. Report on Land Holdings in India, [for 1954-55] with an assumption that no change in this pattern has occurred between 1954-55 and 1967-68. As Table XX indicates, the imposition of income tax on the farm incomes (under the Central Income Tax law) would have provided Rs.13,567 million in 1967-68 as additional resources to the government. This would have been 13 times as much as compared to the the combined proceeds from land revenue and agricultural income tax of all the states. Again, this

TABLE XIX

AVERAGE INCOME PER FARM HOUSEHOLD AND INCIDENCE OF LAND REVENUE IN INDIA  
( First Plan to 1967-68)

Item	unit	I Plan (1951-56)	II Plan (1956-61)	III Plan (1961-66)	1966-67	1967-68
a. Average land revenue per acre (in Rs.)		1.85	2.47	2.93	2.32	2.40
<b>1. Small farmers (below 5 acres)</b>						
b. Income (in Rs.)	Rs.	516	440	410	554	684
c. land revenue per household (in Rs.)	Rs.	4.625	6.175	7.325	5.800	6.000
d. % of c to b	per cent	0.9	1.40	1.78	1.48	0.90
<b>2. Medium Farmers (5 to 10 acres)</b>						
b. Income (in Rs.)	Rs.	1292	1103	1126	1394	1713
c. land revenue per household (in Rs.)	Rs.	13.875	18.525	21.975	17.400	18.000
d. % of c to b	per cent	1.07	1.68	1.95	1.25	1.05
<b>3. Large Farmers (10 to 50 acres)</b>						
b. Income (in Rs.)	Rs.	2129	3133	4241	5460	6711
c. land revenue per household (in Rs.)	Rs.	55.50	74.10	87.90	69.60	72.00
d. % of c to b	per cent	2.58	2.36	2.07	1.27	1.07
<b>4. Very Large farmers (above 50 acres)</b>						
b. Income (in Rs.)	Rs.	7176	10485	14639	18250	22738
c. land revenue per household (in Rs.)	Rs.	138.75	147.60	175.80	139.20	144.00
d. % of c to b	percent	1.93	1.41	1.20	0.71	0.63

Sources : (a) Statistical Abstracts of India, 1965 to 1968 and Table X of this paper  
(b) Madalgi (25) for average income of farm households  
(c) mean holding in each category multiplied by average land revenue/acre

TABLE XX

## FARM INCOMES AND POTENTIAL OF INCOME TAX IN INDIA, 1967-68

Category of farm household	Average income per farm household (Rs.)	Number of households (million)	Average potential income-tax (Rs.) per household	Total potential revenue (Rs. million)
1. Small farmers (upto 5 acres)	684	53.62	Nil	Nil
2. Medium farmers (5 to 10 acres)	1713	9.57	Nil	Nil
3. Large farmers (10 to 50 acres)	6711	10.61	421.10	4266.81
4. Very large farmers (above 50 acres)	22738	2.80	3321.40	9299.92
			TOTAL..	<u>13566.73</u>

Sources : (i) National Sample Survey, Report on Land Holdings (1960) same as Table 19  
(ii) Report on Currency & Finance, Bombay, (1967-68) for mid-year population in 1967  
(iii) James Cutt (5) for rates of income tax (p.86)



would have not only financed the programs for agricultural development of all the states in 1967-68 (Rs.5020 million :Table XIII), but would have also provided over Rs.8.5 billion for the development of non-agricultural sector. To put it in a different way, the entire outlay of the yearly plan for 1967-68 could have been obtained by taxing the income of large farmers who constitute only 17.5 per cent of the entire agricultural population.

Administrative feasibility of Agricultural Income Tax on the large farmers :

Professor Ranga (35a) and Chatterjee (4a) maintain that taxation of agricultural incomes in India will involve serious administrative problems. In the first place, they argue, the estimation of the net income of an agricultural household is difficult in the Indian situation, where most of the farmers do not maintain any accounts. Secondly, even if the income of a household is ascertained, assessment of income-tax and its collection would pose grave administrative difficulties.

It should be conceded that the estimation of farm income and its assessment for tax purposes would be difficult in the Indian context. The imputation of farm costs involves a considerable degree of arbitrariness. Even though for our analytical purpose we have used Madalgi's estimates of the net farm income, yet, for the administrative convenience gross, rather than the net farm income should be accepted as a basis for taxation. In other words, separate tax rates for gross income on farms and net income for non-farm incomes could be used to avoid a number of administrative bottlenecks.

The income tax authorities may ascertain the gross income of large farmers on the basis of their holdings and the standard yield that could be obtained from the given type of soil. Such a concept of standard yield will have to be developed for each region in a state by the departments of agricul-

ture and revenue on the basis of soil surveys and normal yield under different types of soil and technological level of the individual farmer. It will also require the submission of periodic reports by the village-level revenue officer, i.e., the patwari to the income tax authorities about the crops grown by the large farmers. Moreover, a copy of the pass-book on landholdings should be provided to the district Income-tax Department. Apparently, these measures will require a more efficient and firm tax-administration than what exists today. However, taking in view the revenue potential and equity implications of an income tax on the large farmers, it seems desirable to make every effort to improve the Indian tax-administration.

AGRICULTURAL INCOME TAX AND THE LARGE FARMERS :

According to a recent Reserve Bank of India survey, about 35 per cent of the farm incomes are received by the top 16 or 17 per cent of the (rich) farm households. (31) Assuming that the pattern of income distribution has been unchanged over these years, out of the total agricultural income of Rs. 130 billion in 1967-68, about Rs. 45.5 billion would have been received by these rich farmers. Even if they were required to pay Rs.13.6 billion in the form of income-tax, it would have been less than 30 per cent of their total income. Thus imposition of income-tax on the farm incomes would not squeeze severely the large farmers. For the top (very large) farm households, who receive 17 per cent of the agricultural incomes, the income tax liability would have been about 42 per cent of their incomes (Rs.9.3 billion out of Rs.22.1 billion earned by them). But on the grounds of equity and sectoral balance in the incidence of taxation, this does not seem to be unfair and discriminatory against the large farmers.

POLITICAL FEASIBILITY OF AGRICULTURAL INCOME TAX :

It is argued that the state governments rely heavily on the support of farmers, and will not allow the Central Government to displease these people by imposing agricultural income tax. (35a) Ranga also contends that the farmers are already paying heavy taxes on consumer goods and an additional tax on their incomes will agonise them. These fears appear to be unrealistic, especially in view of the present political climate in the Indian villages. The <sup>present</sup> land-grab movement by small farmers and land-less farm workers should not be dismissed as a political maneuvering of the leftist parties. Rather, it is a result of the growing gap between the rich and the poor farmers. We have a strong feeling that imposition of progressive income tax on the large farmers will result in a greater political stability in the Indian states. This device will reduce the prevalent inequality in the distribution of income and wealth in Indian agriculture, and will enable the government to obtain whole-hearted support from the small and medium farmers as well as the land-less farm workers who constitute 80 per cent of the farm-population.

It can also be suggested in this context that part of the proceeds from agricultural income tax be spent for the welfare of small farmers and farm workers. This will further strengthen their political support to the state governments.

Objections to the ideal of taxing farm incomes are, therefore, illusory. As we have argued above, such a device will provide more than Rs. 33.5 billion to the planners for financing the plans, and does not seem to be difficult for implementation. Besides, it will bring in uniformity in the policy with respect to agricultural taxation in all the states.

SUMMARY & CONCLUDING REMARKS :

In this paper we have examined the importance of additional taxation in financing Indian plans. It has been demonstrated at length that unlike Japan and Taiwan, the burden of financing economic development in India has fallen largely on the non-agricultural sector, and that since 1951 the relative burden of tax on the farm sector has declined. It has also been explained that the present policies with respect to land revenue and agricultural income tax are obsolete, and have utterly failed to mobilise increased resources for the country's economic development.

We have also argued in this Paper that the present agricultural tax system is not based on the basic principles of a sound fiscal policy. It has failed to check the growing disparities in the distribution of agricultural income and wealth. Due to Green Revolution and adoption of new high yielding varieties over the vast cropped area all over the country, farm incomes have increased enormously. However, bulk of such increase in the agricultural incomes has benefited the large farmers, while the gains to small and medium farmers have been very small. Coupled with a highly regressive agricultural tax policy, however, it has resulted in large disparities in the distribution of income and wealth.

Moreover, the growth of agricultural incomes has been higher in some states than in others. Since the rates of land revenue and agricultural income tax are different in different states, apparently there have occurred wide inter-regional disparities in agricultural incomes. The

existing agricultural tax policy (with land revenue and states' agricultural income tax) has thus not only failed to provide additional resources for the overall economic development, but it has also been responsible for increased inter-regional and intra-sectoral disparities in the distribution of income and wealth. Besides, the growing discontentment among the small farmers and the farm-labor has also emanated from the reluctance of the government to tax the richer section of the agricultural community.

However, inspite of the growing need for additional resources for financing the plans, state governments have become increasingly dependent on the Central Government. Thus, the farmers have not only failed to provide resources for the development of the non-agricultural sector, but they have also remained unable to finance the development of their own sector.

The potential of agricultural income tax on the large farmers (under the Central Income Tax law) has been demonstrated in this paper. To capture this potential, all farm households having 10 acres or more of land should be required to fill out tax returns. It would not be inappropriate to assess the gross income of these households on the basis of their holdings and level of technology. In the ultimate analysis, the burden of proof must fall on the tax-payer. Such a policy will force them to maintain proper accounts and thus would simplify the tax-administration.

As we have demonstrated in this paper, an income tax on the large farmers will involve less than 18 per cent of the farm households, and thus should not present too great an administrative difficulty. We have also argued that such a change in the tax-policy would be a welcome gesture for over 80 per cent of the farmers who have not gained much from the Green

Revolution. In view of the present political climate in India, it seems, the lobby of the rich farmers can not hold its influence in the state legislative assemblies for a long time. We also feel that there is a need for certain drastic changes in the government policy for the small farmers and the farm-labor. Programs for raising their efficiency and level of income must be prepared and put to action before it is too late. This seems important in view of the vast market these farmers (small farmers and the farm workers) offer for the industrial products and transport & communication services. An agricultural income-tax on the large farmers would enable the government to implement various programs for improving the economic conditions of these sections and would thus accelerate the pace of industrialization. Besides, such an improvement in their conditions would also lead to greater political stability.

Apart from providing additional resources for the economic development, this device would also restore inter-sectoral balance in the incidence of taxation. More equitable rates of taxation for all the sectors and for all the regions is a vital force for a long term economic development of a country. Contrarily, continuation of the present stalemate in the agricultural-tax policy may have grave economic and political implications, and may thus jeopardise the process of economic development in India.

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APPENDIX K

**DIRECT TAX BURDEN ON THE AGRICULTURAL AND NON AGRICULTURAL SECTORS IN INDIA : 1950-51 to 1969 70**  
(Rs. Million)

Year	AGRICULTURAL SECTOR			NON AGRICULTURAL SECTOR					TOTAL
	Land Revenue	Agricultural income Tax	Total	Personal income tax	Corporation tax	Wealth Tax	Gift & Expenditure Tax		
1950-51	510	36	546	1327	405	--	--	1732	
1955-56	780	77	857	1313	370	--	--	1683	
1960 61	972	95	1067	1674	1110	82	18	2884	
1961-62	952	94	1046	1654	1565	83	20	3320	
1962-63	1200	96	1296	1860	2215	95	19	4189	
1963-64	1234	93	1327	2586	2746	102	12	5446	
1964-65	1198	107	1305	2666	3141	105	27	5939	
1965-66	1119	99	1218	2718	3048	121	27	5914	
1966-67	896	105	1001	3087	3289	106	18	6500	
1967-68	960	120	1080	3256	3103	107	13	6479	
1968-69	1020	120	1140	3380	3220	110	18	6728	
1969-70 (Budget)	1040	120	1160	3623	3262	120	15	7020	

Sources : Reserve Bank of India Bulletins, April 1968, June, 1968, April 1969, and June, 1969.  
Reports on Currency & Finance, Reserve Bank of India, Bombay 1. (1961 to 1968)

APPENDIX D

S.S. MADALGI'S ESTIMATES OF FARM INCOME IN INDIA, First Five  
Year Plan to 1967-68

Category of farm households	FARM INCOME PER HOUSEHOLD (Rupees)				
	I Plan	II Plan	III Plan	1966-67	1967-68
1. Small Farmers (below 5 acres)	516	440	410	554	684
2. Medium Farmers (5 to 10 acres)	1292	1103	1126	1394	1713
3. Large Farmers (10 to 50 acres)	2129	3133	4241	5460	6711
4. Very large farmers (above 50 acres)	7176	10485	14639	18250	22738

Source : S.S. Madalgi, "Estimates of Farm Income in India," in Economic & Political Weekly, March 28, 1970



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