II. INTEGRATION OF FEDRAL REVENUES AND EXPENDITURE.

4. With effect from the date on which federal financial integration becomes effective, all items of "federal" revenues and "federal" expenditure in Hyderabad, together with the administration of the Departments concerned, should be taken over by the Central Government, as falling within their functional ambit.

The following Departments (*inter alia*) would thus be transferred to the control of the Central Government :—

(1) *"Federal" Revenue Departments* :
Taxes on Income.
Central Excise Duties.
Railways.
Posts and Telegraphs.
Telephones.
Currency and Mint.

(2) *Other Federal Departments* :
National Highways.
Defence (sanctioned I. S. F. Units only).
Aviation.
Broadcasting.
Meteorology.
Archaeology.
Geological Survey.
Patents, Copyrights and Trade Marks.
Registration of Joint Stock Companies and Firms.
Audit and Accounts.
Insurance.

Even if, for administrative reasons, the taking over of any of the "federal" services is postponed for a short period, the Government of India should nevertheless assume financial responsibility for (and consequently financial control over) the Departments concerned. In other words, any "federal" Departments not taken over immediately upon federal financial integration must be administered by the Hyderabad Government on "agency" terms to be agreed upon between the two Governments.

Net "Revenue-gap" arising out of Federal Financial Integration

5. Statements I and II appended to this Report bring out the net revenue effect upon the finances of Hyderabad of

(*i*) the transfer of "federal" revenues and "federal" expenditure to the Centre and the extinction of certain "immunities" ; *and* (*ii*) the abolition of internal customs duties, as a result of federal financial integration.

The figures in Statements I and II are based upon the Budget Estimates of the State for its financial year 1358 Fasli (ending 30th September 1949) and are given here purely for illustrative purposes. They are subject to the following limitations :

(*i*) Many of the figures will require further scrutiny and correction in the light of the remarks embodied in the notes appended to the Statements themselves.

(*ii*) Furthermore, when decisions are taken concerning some of the matters referred to in Parts I and II of our main Report, corresponding modifications in the computations must be carried out.

(*iii*) The final computations must be based on the " actuals " of the " basic period " prescribed for the purpose of working out the financial adjustments required, for the transitional period between the Government of India and the State. As pointed out in paragraph 4 of Part II of our main Report, this " basic period " in the case of Hyderabad would be

(*a*) in regard to Revenue, the three financial years of the State immediately preceding the date of financial integration ; and

(*b*) in regard to Expenditure, the last completed financial year of the State immediately preceding financial integration.

6. It will be seen from Statements I and II that the net dependence of Hyderabad on " federal " revenues and on internal customs duties may be analysed (in round figures) as follows :—

Rs. in lakhs.

	Internal Customs	" Federal " Revenues	Total
Revenue	400	557	957
Expenditure	35	336	371
Balance	365*	221	586

The total net " revenue-gap " resulting from federal financial integration will thus amount to Rs. 586 lakhs.

Although the above figures would require revision in certain respects as already indicated, they are of a sufficient order of accuracy for assessing the effects of federal financial integration and for considering the nature of transitional financial

*Includes Revenue formerly creditable to Sarf-i-Khas.

adjustments required so as to avoid any sudden dislocation of the State's financial structure.

Financial adjustments required

Internal Customs.

7. The loss of revenue which will result from the total abolition of internal customs duties is not, strictly speaking, a consequence of federal financial integration as such but arises from the operation of Articles 16 and 244 of the Draft Constitution. Accordingly, and also for the reasons given in paragraph 22 of Part I of our main Report, there can be no question of the Central Government extending any financial assistance to the State in regard to this matter. The loss must be made good by the State itself, by developing alternative sources of revenue in the "provincial" field.

In view of the large amount involved, however, the abolition of these duties in Hyderabad must necessarily be spread over some years. We suggest the following scheme :—

(*a*) In 1359 Fasli (1949-50), there should be *no* increase in the present *rates* of Customs Duties (or of export "surcharges") or in the *items* subjected to such duties or charges.

(*b*) During 1359 F. the subject of general Sales Tax should be thoroughly investigated and the necessary organisation planned and set up well before the end of that year.

(*c*) In 1360 F. (1950-51), a low general Sales Tax should be imposed ; and Customs Duties (and Surcharges) should be abolished on corresponding items. In effect this will mean the continuance of Customs Duties and Surcharges upon only those items or transactions which are exempted from Sales Tax.

(*d*) The process in (*c*) above should be carried further into 1361 F. (1951-52).

(*e*) All Customs Duties and Surcharges should be abolished in 1362 F. (1952-53), *or* as soon as the net revenue from Sales Tax reaches Rs. 350 lakhs, *whichever may be earlier.*

"Federal" Revenues and Expenditure

8. There remains the net "federal" revenue-gap of Rs. 221 lakhs to be considered. Following the general plan which we have adopted in the case of other States, we recommend the following scheme of transitional adjustments for Hyderabad :

(1) If "R" represents the net *total* financial dislocation as a result of federal integration (*including* the loss from the abolition of internal

Customs duty as computed with reference to the actuals of the prescribed "basic period"); and

if "C" represents the net loss from the abolition of the internal customs duties included in "R"; then the Central Government must guarantee to re-imburse to the Hyderabad Government a sum of Rs. (R—C) per annum, for a transitional period of ten (or fifteen) years, as may be provided in Article 258 of the Draft Constitution when finally passed.

(2) The guarantee of reimbursement should be implemented by the Central Government as follows:—

(*a*) By paying to the Hyderabad Government its share of divisible Income-tax (and of all other divisible "federal" taxes, such as they may be from time to time) computed in the same manner, on the same basis and in accordance with the same principles as applicable to the Provinces *of India; and*

(*b*) to the extent that the amount payable under (*a*) should fall short of the guaranteed amount in any year, by further paying to the Hyderabad Government an amount equal to the short-fall, as a special *ad hoc* grant-in-aid in that year;

(*c*) in any year in which the amount payable under (*a*) does *not* fall short of the guaranteed amount, the Hyderabad Government will receive the amount due under (*a*), and the guarantee will be inoperative for that year.

(3) The Hyderabad Government should not be required to bear any portion of the net "federal" revenue-gap during the transitional period; the reason is that their net loss by the abolition of internal customs would itself far exceed 40% of the total "Revenue-gap"; (*cf.* paragraph 32 of Part I of our main Report).

(4) With effect from the prescribed date, the Hyderabad Government should as a direct consequence of federal financial integration, be entitled to receive food subsidies as in the case of Provinces at the rate of 75% of the loss on the sale of imported foodgrains. These subsidies and all grants-in-aid, 'bonuses' and other forms of financial and technical assistance from the Centre, whether in cash or kind, whether on revenue or capital account, and whether by way of loans or outright grants, should be payable to the Hyderabad Government by the Government of India quite independently of the above scheme of transitional adjustments, i.e., *in addition to* the amounts guaranteed under sub-paras (1) and (2) above, and on the same basis and principles as applicale to Provinces.

(5) **Privy Purse**

The figures given in paragraph 6 above have been worked out on the assumption that the Ruler's "Privy Purse" would continue to be a charge on the State Revenues, even after federal financial integration. By "Privy Purse" is meant the *personal* allowance payable to the Ruler from the State revenues, as distinguished from—

(*a*) Allowance to his relatives ;

(*b*) Allowance payable to the Ruler as Expenditure incurrable for him as Head of the State (*e.g.* Rajpramukhs in Unions or Governors in Provinces).

If it should be decided ultimately that for political and/or constitutional reasons "Privy Purse" should be payable by the Centre as a "federal" charge, it would follow that in the case of Hyderabad there should be a classification of the existing payments to the Ruler under two heads, one corresponding to allowances payable to Rajpramukhs of Unions or to Governors of Provinces, and the other corresponding to "Privy Purse" of Rulers of States which have been integrated with Unions. The former will continue to be a charge on the revenues of the State, while the latter must be taken up by the Central Government and would accordingly be included in Statement II as "federal" expenditure. The *net* "Revenue-gap" would be recomputed on this basis but there would be no other change in the scheme of transitional financial adjustments outlined above.

9. Our proposals will ensure that Hyderabad finances will be fully protected for the transitional period of ten (or fifteen) years, to the extent of the State's present dependence upon "federal" revenues. On the termination of the transitional period, when there would be no longer any guaranteed reimbursement, the financial relationship between Hyderabad and the Central Government would be exactly the same as that between any of the Provinces and the Centre.

We are confident that Hyderabad's share of divisible "federal" taxes and the normal development of "Provincial" revenues in the State would render it possible for the State Government to dispense with the Central guarantee at the end of the transitional period, without creating any dislocation of its finances.

Currency and Coinage

10. Reference must be made here to the local "Osmania Sicca" Currency and Coinage of Hyderabad. Federal financial integration will involve the assumption by the Central Government of the responsibility for the entire currency administration in Hyderabad ; accordingly the entire stock of unissued currency notes and coinage on hand together with all the connected assets in the Paper Currency Reserve and in the mint, must be taken over by the Central Government on the date of financial integration.

For the purpose of computation of loss of revenue to the State on financial integration, we recommend that the income from the Paper Currency Reserve, the O. S. Stabilisation Reserve, and the Mint should be based on the average net receipts of the three financial years of the State ending 30th September 1946. This will eliminate not only the period 1946-47 and 1947-48 during which, for political reasons, the State Government embarked upon a policy of ousting Indian Currency from the State, but also the period subsequent to the police action during which there has been an abnormal demand for conversion of the State Currency into Indian Currency.

It will be for the Central Government to decide, in due course, whether and if so when and in what manner, the Hyderabad currency and coinage should be demonetised. Any loss (or profit) on the substitution of Indian currency and coinage for the State currency (after federal financial integration) will then be on the Central Government's account. Meanwhile, as we have said, the Mint, the Paper Currency Reserve and the O. S. Stabilisation Reserve together with the relative assets and investments should be taken over by the Government of India upon federal financial integration. The two Reserve Funds would be administered as separate, self-contained and self-liquidating Statutory Funds, in accordance with

(*a*) the statutory obligations of the Funds themselves, and

(*b*) such currency and coinage policy as the Centre might decide to adopt in due course.

Pending a decision as regards the future of the State's Currency, it is essential that the public should be given an assurance that the value of the Hyderabad currency and coinage would be *firmly* maintained at the present official rate of exchange and that unlimited exchange facilities would be available to the public at that rate ; it would also be necessary, in the event of a final decision being taken to demonetise the local currency, to give adequate facilities to all holders of Hyderabad currency to effect conversion of their holdings into Indian Government currency, over a sufficiently long period and at the official rate of exchange, at all treasuries and banks in the State.