

## I. GENERAL PRINCIPLES

### Terms of Reference

The terms of reference contained in the Government of India (Ministry of States) Resolution No. F. 60-IB/48, dated the 22nd October 1948, in so far as they relate to the problems of Federal Financial Integration are reproduced below:—

“To examine and report upon:

- (1) \* \* \* \*
- (2) the desirability and feasibility of integrating Federal Finance in Indian States and Unions of States with that of the rest of India, to the end that a uniform system of Federal Finance may be established throughout the Dominion of India;
- (3) whether, and if so, the extent to which, the process of so integrating Federal Finance in the Indian States and Unions with that of the rest of India should be gradual and the manner in which it should be brought about, and the machinery required for this purpose, especially as regards the legislative groundwork and the administrative organisation necessary for the imposition, assessment and collection of Federal Taxes;
- (4) the results of such a policy of integrating Federal Finance upon the finances of Indian States and Unions and the consequential financial adjustments and relations which should subsist between the Governments of the Indian States and Unions on the one hand and the Government of India on the other;
- (5) \* \* \* \*
- (6) any other consequential and/or cognate matters which the Committee may consider as arising out of the foregoing terms of reference.”

Our General Report contains the reasons for the withdrawal of the first and fifth terms of reference; here it is enough to state that they would have involved us in a far more detailed and time-consuming enquiry into the field of “Provincial Finance” of Indian States and Unions than would be necessary for investigating the problems arising out of federal financial integration, considered by itself.

### Preliminary Remarks

2. The scheme of federal financial integration for the Travancore-Cochin Union as presented in this Report, is based upon a detailed local investigation of the technical data by one of us (Mr. Dandeker), followed by exhaustive discussions first with Departmental officers, and, finally, at Cabinet level, in the two States. Although our original objective was to work out a scheme separately for each of the States, the final plan as here presented has been evolved with a view to its suitability for the contemplated *United State* of Travancore and Cochin, after joint discussions with representatives of both the States.

We have not, however, extended our enquiry to cover the wider financial problems arising out of the merger of the two States as such, except that we have taken cognisance of the fact that the immediate discontinuance of the land customs arrangements in Travancore has become a live issue in connection with the merger.

We are glad to record that the discussions were throughout conducted in a cordial atmosphere and that the scheme as a whole was finalised with the fullest co-operation and general support of the Prime Ministers of the two States and of their colleagues in their respective Cabinets.

### General Line of Approach

3. The general theory of "federal" integration of States and Unions, and the specific principles relating to federal *financial* integration are set out at some length in our main Report. In this Interim Report we need refer only to our main conclusions on these subjects, which are as follows:—

#### (i) Separation of "Central" from "Provincial" functions:

The Governments of Indian States and Unions are at present *composite entities* which, subject to certain over-riding limitations imposed by the Instruments of Accession and the Stand-still Agreements executed by them, function both as "Central" Governments and "Provincial" Governments within their respective territories. Their integration with the Dominion of India will not therefore be complete until a further advance is made in the political, constitutional, financial and administrative fields, so far as *Central functions* are concerned. Such integration, especially in the field of federal finance, is in our view both desirable and feasible.

In the new relationship between Indian States and the rest of India brought about by the abolition of the old concept of "Paramountcy" in August 1947, there is nothing to distinguish the Indian States from Provinces. The States and their peoples should accordingly be entitled, in financial as well as in other matters, to precisely the same treatment from the Central Government as the Provinces and the peoples of India; and they must consequently be under an

obligation to contribute in the same manner to the revenues of the Central Government. This new concept has been embodied in the Draft Constitution of India which provides for the achievement of complete parity between Provinces and States in the matter of their relations with the Central Government, subject only so far as financial matters are concerned, to such transitional arrangements as may be necessary for a specified period, (*vide* Article 258).

**(ii) Integration of Federal Finance:**

Considered analytically, the process of federal financial integration involves:—

- (a) a bifurcation of the present composite Governments of the States into two functional entities—"Central" and "Provincial",—each with such revenues, expenditure, assets and liabilities as are appropriate to its functions;
- (b) immediately upon such bifurcation, the integration or merger of the "Central" aspect and functions of the State Governments with the Central Government of India; and
- (c) 'transitional' arrangements to provide, on the one hand, for gradualness in the process of *administrative* transfer of certain functions to the Government of India, and on the other, for necessary *financial* adjustments to ensure that there would be no sudden dislocation in the financial structure of the States when left with purely "Provincial" resources and "Provincial" functions.

**(iii) Principles underlying financial adjustments:**

The underlying aims of the scheme of financial adjustments referred to in the preceding sub-paragraph should be that—

- (a) Parity with Provinces in the matter of financial relationship with the Centre must be achieved in as short a period as possible, consistently with the maintenance of the financial stability of the States.
- (b) The assumption by the States of their share of the burden within the prescribed period should be *gradual*.

**(iv) No "compensation" to be paid:**

On the principles stated, and apart from any adjustments required during the transitional period to avoid dislocation, no question of "compensation" as such, whether for assets or revenues (passing to the Centre upon federal financial integration), would arise. For there would be involved no buying or selling,

no acquiring or surrendering, but an outright merger of the "Central Government" of the States with the (Central) Government of India on a *functional* basis.

### Practical Issues

4. Having clarified the basis upon which alone the problem can be properly approached, the practical issues which arise for consideration may be stated as follows:—

- (i) What are the essential requirements from the constitutional angle with reference to which the scheme of federal financial integration should be formulated?
  - (ii) What are the specific functions and responsibilities, revenues, capital assets and liabilities which must be transferred to the Government of India as "functional" successors of the Travancore and Cochin States, in the field of "Federal Finance", and what will be the financial consequences to the States of such a transfer?
  - (iii) To the extent to which the transfer will cause a dislocation in the States' budgets, what Revenue and/or Capital adjustments are called for having regard to the fundamental principles enunciated in the preceding paragraph?
  - (iv) What adjustments will be necessary between the Central Government and the Travancore-Cochin Union in regard to the *current* assets and liabilities of the States, after all the *Capital* assets connected with 'Central' functions have been vested in the Central Government as indicated in (ii) above?
  - (v) What other consequential matters will require to be dealt with?
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