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**INDIAN STATES
FINANCES ENQUIRY
COMMITTEE**

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TRAVANCORE—COCHIN
INTEGRATION OF FEDERAL FINANCES

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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 of 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?

II. BASIC REQUIREMENTS OF FEDERAL FINANCIAL INTEGRATION

Constitutional Requirements

5. (1) After careful consideration, we have come to the conclusion that federal financial integration should be preceded by *complete* "accession" on all subjects (including Finance and Taxation) comprised in Lists I and III of the Seventh Schedule to the Draft Constitution.

It would no doubt be possible to work out a plan of *financial* integration without necessarily requiring full accession on any subject other than financial and taxation matters. We are of the opinion, however, that in the new context of the political relationship between the States and the rest of India, it would be an unjustifiable anachronism to retain or provide for any limitations to full accession (*e.g.*, as regards "Indian State Railways", or as regards Posts and Telegraphs, Telephones, etc. in Article 224 of the Draft Constitution). We are confident that all the States with whom we have so far discussed the matter will accept this recommendation.

(2) The actual exercise by the Government of India, as a result of "complete accession", of the legislative, judicial, executive and administrative competence in respect of acceded subjects may, however, be subject to the principle of '*gradualness*' in the following directions, to the extent justified by the circumstances:—

- (a) the actual taking over of *direct* administration by the Centre of federal functions in respect of acceded subjects, *other than Railways and taxation*, may be a gradual process, according to administrative convenience.
- (b) the raising of *rates* of income-tax in the States to the full Indian level, may also be a gradual process, if for any reasons it should not be possible to assimilate them at once. (This problem does not, however, actually arise in the present case, as rates of Income-tax in Cochin are already at the Indian level and those in Travancore can readily be raised to that level at one step).

In all other respects, however, there must be complete equality with Provinces.

(3) The scheme of financial adjustments during a transitional period preceding complete parity with Provinces must be so devised that all the adjustments should automatically terminate after a *maximum* period of 10 years, as contemplated in Article 258 of the Draft Constitution. We are aware that an amendment to this Article has been tabled by the Drafting Committee which seeks to increase this period to 15 years; it is accordingly necessary to indicate the modifications which would be justified in the plan if a transitional period of 15 years should ultimately be accepted by the Constituent Assembly.

(4) The scheme of financial adjustments should also take into account the provisions of Articles 16 and 244 of the Draft Constitution which provide for a maximum transitional period of 10 years for the abolition of internal customs barriers within the country. In the case of the Travancore-Cochin Union, however, it is unnecessary to invoke these provisions, as we understand that circumstances have made it desirable that the abolition of land customs should be made effective immediately upon the constitution of this Union.

Date of Federal Financial Integration

6. We were first inclined to recommend that as in the case of other Indian States and Unions the integration of federal finance in Travancore and Cochin should be effective only from the 1st April 1950, by which date the new Constitution of India would, in all probability, have come into force. In the course of our final discussions with the Governments of Travancore and Cochin, however, it became clear that in view of the financial difficulties which the two States would initially have to encounter as a consequence of their merger into a Union, it would on the whole be beneficial to them to agree to federal financial integration with effect from the 17th August 1949 (the date of commencement of their next financial year) under the *present* Government of India Act itself. We are satisfied that the State Governments would welcome such early financial integration with the Government of India and we recommend accordingly.

The legal requirements connected with *complete* accession on the "Federal" and "Concurrent" lists under the Government of India Act, 1935, (as amended to date), will however require to be worked out carefully.

Whichever of the two dates, 1st April 1950 or 17th August 1949, may ultimately be adopted for federal financial integration, the main features of the scheme which has been evolved by us will not require any substantial modification. (References in later paragraphs of this report to "the prescribed date" will mean the date which may be actually decided upon for the introduction of federal financial integration in the Travancore-Cochin Union).

Practical Consequences

7. The assumption by the Government of India of "Central" Functions in Travancore and Cochin with effect from the date of federal financial integration, will have the undermentioned practical consequences:—

(1) The administration and control of the following subjects and items, namely

- (a) all "Central" sources of revenue,—*e.g.*, Customs, Income-tax, "Central" excises, Railways, Posts and Telegraphs, Telephones;

- (b) all "Central" items of expenditure—*e.g.* Army (excluding non-ISF units and establishments), Civil Aviation, Broadcasting, Meteorology, Patents, Copyrights and Trade Marks, Registration of Joint Stock Companies and firms, Accounting and Audit in respect of "Central" transactions;
- (c) all *specific Capital assets* (as distinguished from "liquid" assets and investments) connected with "Central" functions, whether productive or non-productive;
- (d) all "*specific*" debts or Capital liabilities connected with such Capital assets,

will pass to the Government of India. They must accordingly take over the administration of the departments concerned, together with all outstandings (including pending assessments, refunds and arrears), liabilities, claims, etc., connected therewith.

(2) If, for reasons of administrative convenience, it should be found desirable to postpone for some time the actual taking over of the departments specified in sub-para. (1) (b) above, there would be no objection to such a course; even so, the *financial* responsibility for those departments (and, therefore, the financial control over them) must be assumed by the Government of India as from the prescribed date. As regards the departments specified in sub-para. (1) (a) above, however, there must be complete taking-over on the prescribed date except, perhaps, of the postal system ("anchal") in the two States.

(3) In regard to the Capital Assets referred to in sub-para. (1) (c) above, there will be no comprehensive list of "unproductive" assets, consisting largely of lands, buildings, aerodromes, laboratory apparatus and appliances, equipment, furniture etc., at present in use by the "Central" Departments. Such assets must be taken over by inventory as at the prescribed date; and no valuation need be attempted as it will serve no useful purpose.

The "productive" Capital Assets connected with "Central" functions referred to in sub-para. (1) (c) above, *viz.*, Railways, Broadcasting, Telephones, Currency and Mint, etc. will be taken over, together with the specific public or other debt, and the cash balance, liabilities and outstandings, if any, relating to them. Their book values are known and must be transferred as such to the books of the Government of India.

(4) There will then remain for allocation and apportionment the "current" or "liquid" assets, the "current" or "banking" liabilities, public debt (other than 'Specific' debt associated with particular capital assets), and also liabilities in respect of specific or non-specific Funds and Reserves, of these two States.

The most convenient procedure would be as follows:—

- (a) *Current Liabilities* must first be allocated between the Central and the State Governments on a “functional” basis, with an *equivalent* allocation of liquid assets and investments to meet such liabilities. In the event of there being a surplus of current liabilities over liquid assets, the Central Government must bear an equitable share thereof.
 - (b) *Specific Funds*, with corresponding assets to the extent available must similarly be allocated on a functional basis.
 - (c) *Non-specific Funds and Reserves*, with corresponding assets to the extent available, will have to be apportioned on some equitable basis (*e.g.* “needs”) between the Central and the State Governments, to be expended in the particular States for the benefit of which they were created.
- [This particular principle has no practical application in the present case, since the liquid assets, after meeting the liabilities and the Funds referred to at (a) and (b) above, respectively, are insufficient to cover the non-specific Funds in full; the Central Government cannot therefore be allotted any portion of such Funds from the Travancore-Cochin Union.]
- (d) *Public Debt*: The Central Government must take over a proper share of the public debt *other* than ‘specific debt’ associated with particular Capital Assets,—“Provincial” and “Central”—referred to in sub-para. (1) (d) above.
 - (e) Finally, should there be a net excess of current liabilities and Funds over liquid assets (as in this case), so much of such excess as represents liabilities owing to *outsiders* must also be shared between the Central and the State Governments in the same manner as the general Public Debt.

(5) The staff actually engaged on work connected with “Central” functions (except such as may be required by the State Governments themselves in connection with their own administrations) should also be taken over by the Central Government in appropriate grades and on terms not less advantageous than those enjoyed by them before the prescribed date. The Travancore and Cochin Governments rightly attach great importance to the utilisation of the existing staff, and in our opinion, every attempt should be made to employ such staff in the appropriate grades of the corresponding Departments under the Government of India.

“Basic Period” for financial adjustments

8. Before considering the revenue effect (upon the finances of the Travancore-Cochin Union) of integrating the “Central” Revenue and Expenditure Departments of these States into the appropriate departments of the Government of India, it is necessary to define the basic period with reference to which the Revenue and Expenditure computations should be made. This is a point of some importance, as all transitional Revenue adjustments in connection with the federal financial integration scheme will be based on such computations. We have given careful thought to this matter and would recommend that the basic period should be fixed as follows:—

- (a) In regard to Revenue, the average of the actuals of the three completed financial years of the States immediately preceding the date of integration.
- (b) In regard to Expenditure, the actuals of the last completed financial year of the States immediately preceding financial integration.

Individual items of Revenue are liable to fluctuation in either direction; and a three-year average for revenue is therefore fully justified. In the case of Expenditure, however, having regard to the trend in recent years, the level is hardly likely to go below that reached in the latest year; only that year can therefore be taken as the base for our purposes.

It may be mentioned here, however, that the adoption of a different basic period, viz., only one financial year immediately preceding federal financial integration, will be inevitable in the case of other Unions such as Saurashtra, Madhya Bharat etc. where it will be impossible to take any earlier year as the base, since those Unions include several covenanting States having no reliable financial data for any earlier period.

III. THE "REVENUE—GAP" ARISING OUT OF FEDERAL FINANCIAL INTEGRATION

The Size of the Revenue Gap

9. Statements I and II attached hereto, (each of which has been prepared separately for the two States), are designed to show the effect on the revenues and expenditure, respectively, of Travancore and Cochin, consequent upon the complete integration of their federal finances with those of the Government of India on the lines indicated in Section II of this Report. The figures compiled in these Statements are subject to the following important limitations:

- (a) Computationally, many of them will require further scrutiny and correction in the light of the remarks embodied in the "Notes" appended to the Statements;
- (b) Furthermore, when decisions are taken in respect of some of the matters referred to in Sections IV and V of this Report, some further modifications in the computations may be necessary;
- (c) Statements I contain figures relating to the States' financial years 1122 and 1123 M.E. only; when these statements are prepared in final form, the figures relating to 1124 M.E. will also have to be inserted. Similarly, Statements II contain figures relating to 1123 M.E.; these will have to be substituted by those for 1124 M.E.

For illustrative purposes, however, the figures relating to 1123 M.E. alone (as embodied in Statements I and II) have been referred to in the following paragraphs in computing the financial adjustments required during a transitional period following federal financial integration; but the final computations of these adjustments, following the same principles and based on correctly prepared Statements of "Central" revenues and expenditure with reference to the "basic period" recommended in paragraph 8 above, will of course have to be worked out afresh.

It will be seen from Statements I and II that the *net* dependence of Travancore and Cochin Governments on "Central" Revenues during 1123 M.E. was as follows:—

	Travancore	Cochin
	(Rupees in lakhs.)	
(i) "Central" Revenues (collected in the State) which will merge with the revenues of the Government of India.	186.67	117.61
(ii) Revenue from Internal Customs Duties which will be lost altogether after federal financial integration.	103.02	..
Total	289.69	117.61

	Travancore	Cochin
	(Rupees in lakhs)	
(iii) Expenditure which will be taken over by the Government of India	59.14	14.92
(iv) Expenditure on Internal Customs which will cease to be incurred.	2.94	..
	62.08	14.92
Total	62.08	14.92
<i>Net "Revenue-Gap"</i>	227.61	102.69
made up of:—		
'Central' Revenues less 'Central' Expenditure	127.53	102.69
Internal Customs Revenue less Cost of Collection	100.08	..
	227.61	102.69

It may be mentioned here that the Travancore and Cochin Governments in common with other States have been promised by the Central Government a temporary measure of relief *ex gratia* by way of subsidies on imported foodgrains to the extent of 50 per cent. of the loss on sale of such foodgrains, together with a "bonus" at the rate of 8 annas per maund on foodgrains procured internally and a further "bonus" of 8 annas per maund on foodgrains exported to other parts of India

10. The net burden of federal financial integration, on the basis of the actuals of 1123 M.E., would thus be Rs. 227.61 lakhs in the case of Travancore and Rs. 102.69 lakhs in the case of Cochin. Clearly, the *whole* of this burden cannot possibly be shifted to these States; it must, in other words, be shared between the Travancore-Cochin Union and the Central Government in some equitable manner.

To that end we recommend the scheme set out below which we have worked out after giving this matter our most anxious and sympathetic consideration; some of our proposals will be effective immediately from the prescribed date, while others are in the nature of transitional financial adjustments extending over a period of ten or fifteen years as may be finally enacted in Article 258 of the Draft Constitution.

(1) The Internal Customs Duties now imposed in Travancore upon trade with India should be entirely abolished with effect from the prescribed date; and the net loss (Rs. 100 lakhs) resulting therefrom should be wholly borne by the Travancore-Cochin Union.

(2) The residual net 'Central' revenue-gap of the two States taken together, (amounting to Rs. 230 lakhs), should be re-imbursed to the Travancore-Cochin Union by the Central Government under a "tapering" arrangement which

would guarantee payments as follows:

(i) From the prescribed date up to 31st March 1955, the entire residual net revenue-gap of the two States taken together, *i.e.*, Rs. 230 lakhs *per annum*;

(ii) From 1st April 1955 to 31st March 1960, the residual net revenue-gap of *Travancore* in full, and a gradually reducing part (working down finally to 60 per cent.) of the net revenue gap of *Cochin*, *i.e.*

In respect of	For Travancore	For Cochin (Rupees in lakhs)	Total for Travancore Cochin Union
1955-56	127.5	(102.7—8)	222
1956-57	127.5	(102.7—16)	214
1957-58	127.5	(102.7—24)	206
1958-59	127.5	(102.7—32)	198
1959-60	127.5	(102.7—41*)	189

(iii) Should Article 258 be so enacted as to allow a transitional period of 15 years (instead of 10 years), then for the next five years up to and including 1964-65, the remainder of the net revenue-gap of the two States taken together, *i.e.* Rs. 189 lakhs *per annum*.

(iv) There would be *no guarantees* from 1960-61/1965-66 onwards, according as the transitional period permitted under Article 258 happens to be 10/15 years.

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

(a) By paying to the Travancore-Cochin Union 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 (a) above should fall short of the guaranteed amount in any year by paying over an amount equal to the shortfall, as a special *ad hoc* grant-in-aid in that year, to the Travancore-Cochin Union.

NOTE.—If, in any year, the amount payable under (a) above should itself exceed the amount guaranteed under (2) above, the amount due

* Represents 40% of the net "Central" revenue-gap of Cochin.

under (a) should be paid in any case; and in that event, the proposal under (b) above would be inoperative in respect of that year.

(4) With effect from the prescribed date, the Travancore-Cochin Union should, as a direct consequence of federal financial integration, be entitled to receive food subsidies, at the enhanced rate of 75 per cent. of the loss on the sale of imported food grains, as in the case of Provinces. These subsidies, and all grants-in-aid, 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 Travancore-Cochin Union by the Government of India quite independently of the above scheme of transitional adjustments, *i.e.*, *in addition to* the amounts guaranteed under sub-para. (2) above and *computed on the same basis and principles as applicable to Provinces.*

(5) Furthermore, the above scheme should not prejudice in any way the rights of the Travancore-Cochin Union, (regarded as a 'province', fully integrated financially with the Centre), to submit independently a case for financial assistance under Article 255 of the Draft Constitution, especially with reference to the initial difficulties arising out of the *merger* of the two States, as distinct from those arising out of the integration of 'federal' finances of the new Union with those of the Government of India. (It may be mentioned here that we have expressly excluded from our purview all such problems of 'merger finance').

11. The following comments will explain the principal considerations which have weighed with us in proposing the scheme set out in the preceding paragraph:

(1) Termination of Internal Customs Duties:

The abolition of Internal Customs Duties is a consequence not so much of the integration of the federal finances of States and Unions with those of the Government of India, as of the very fundamental principles of the Constitution itself as embodied in Article 16 of the Draft Constitution. Moreover, under Article 244, a period of 10 years is permissible for the complete abolition of those Duties; this is undoubtedly intended to enable the States concerned to "stagger" the resultant loss, and to recoup it by developing alternative sources of revenue over a considerable period. For these reasons, as also because the abolition of these Duties would confer no corresponding direct benefit (by way of additional revenues) upon the Central Government, the loss arising in this way must clearly be borne by the State concerned. It may be added that any proposal requiring the Government of India directly to render substantial assistance in this respect would be financially quite impracticable, having due regard to the very large amount of revenue derived by several States from such duties throughout India.

On the other hand, the representatives of the Travancore and Cochin Governments emphasised that while the immediate abolition of these Duties had become imperative in connection with the proposed formation of the Union of the two States, it would be altogether impossible for the new Union to bear the resultant loss of revenue except under a scheme of financial assistance from the Central Government. [It may be mentioned here that the chief consideration requiring the immediate abolition of these Duties (on the constitution of the Travancore-Cochin Union), instead of their *gradual* lifting as permitted by Article 244 of the Draft Constitution, is that such Duties exist at present only in the Travancore State; and since it would be difficult to justify their extension so as to embrace the Cochin State also, the obvious course is to abolish them, if some means could be found of "cushioning" the financial shock involved by such a measure]. As to this, we pointed out that if the Travancore-Cochin Union would agree to our scheme of federal financial integration becoming effective simultaneously with the constitution of the Union itself, or from some other conveniently early date, *e.g.*, from the commencement of their next financial year (17th August 1949 corresponding to the first day of 1125 M.E.), the contribution of the Government of India towards *food subsidies* would automatically go up from 50 per cent. to 75 per cent. of the total loss on the sale of imported foodgrains, the latter being the percentage applicable to Provinces. Such an increase in the amount of food subsidies would mean, in effect, that the Travancore-Cochin Union would be provided with additional resources, on a gradually diminishing scale over a period of years, so that they might develop alternative sources of revenue over the same period to cover the loss on account of abolition of land customs. (Indeed, in the first year following federal financial integration, the increase in the amount of Central food subsidies would almost wholly cover the entire loss resulting from the abolition of Internal Customs Duties). If food subsidies should diminish to 'nil' more rapidly than was expected at present, (for example, in consequence of improvement in the internal food situation or fall in prices), such reduction would probably be more than offset by the corresponding reduction of other losses on foodgrains which were at present being wholly borne by the Travancore and Cochin Governments. In either case, an effective means of gradually 'cushioning' the loss of revenue from Internal Customs Duties would thus be available, provided federal financial integration became effective soon after the constitution of the Travancore-Cochin Union.

As this suggestion was accepted by the representatives of the two Governments, it is, in our view, clearly necessary to make federal financial integration effective in this case at least from 17th August 1949 under the present Government of India Act itself, if the loss of revenue from Internal Customs Duties is not to be allowed to jeopardise the financial stability of the Travancore-Cochin Union.

(2) Allowing for Rs. 100 lakhs out of the net revenue-gap being dealt with as above, the residual net revenue-gap of Travancore alone amounts to Rs. 127.5 lakhs. Clearly, no further scope exists for any part of this being borne by the Travancore-Cochin Union during the transitional period; our recommendations accordingly ensure the making good of the whole of this sum by the Central Government to the Travancore-Cochin Union over the entire transitional period of 10 or 15 years (as might be the case) under Article 258.

(3) The rest of the net revenue-gap, namely, Rs. 102.7 lakhs represents the net 'Central' revenue-gap of Cochin. As regards this, we consider that following the pattern of financial adjustments which we have so far evolved for most other States and Unions, it would be equitable if the Central Government were to guarantee to reimburse this to the Travancore-Cochin Union under a 'tapering' arrangement, starting with Rs. 102.7 lakhs and working down, by 40 per cent., to Rs. 61.7 lakhs, over a transitional period of 10 years terminating on the 31st March 1960.

(4) In view, however, of the fact that the Travancore and Cochin States, taken together as a Union, would have jointly to bear the shock of the abolition of Internal Customs Duties from the very commencement of federal financial integration, we consider that the 'tapering' down referred to above, in respect of the reimbursement of the Cochin net revenue-gap, should not commence until the 6th year and should terminate in the 10th.

(5) In this way, we have evolved a scheme under which the Travancore-Cochin Union would

- (i) from the very outset, be required to bear the loss resulting from the abolition of Internal Customs Duties; *and*
- (ii) from the 6th to the 10th year be required to bear an amount working up gradually to 40 per cent. of the net revenue-gap of Cochin; *and*
- (iii) from the 11th to the 15th year, be required to bear no further burden, (provided Article 258 of the Draft Constitution, as finally enacted, should provide for a period of 15 years).

(6) We have also provided that if in any year the Travancore-Cochin Union's share of divisible income tax, (and of other divisible federal taxes such as they may be from time to time), should *exceed* the reimbursement guaranteed for that year, it should be the larger sum that should be payable to the Travancore-Cochin Union.

(7) For the rest, our proposals are designed to achieve for the Travancore-Cochin Union an immediate financial parity of treatment with the Provinces of India, in *all* respects, by the Central Government.

(8) On the termination of the transitional period under Article 258, there would, of course, be no guaranteed reimbursements such as those referred to in sub-paras. (3) and (4) above, read with sub-paras. (5) and (6); in other words, there would thereafter be no distinction at all between the financial rights of the Travancore-Cochin Union and those of any Province *vis-a-vis* the Central Government. We are reasonably confident, however, that those rights will, by then, be yielding *more* revenue to the Travancore-Cochin Union than the guaranteed reimbursements under our scheme. In other words, in our opinion, it is very likely that in about eight to ten years after federal financial integration the Travancore-Cochin Union will have completed its transition to a wholly "provincial" basis of financial relationship with the Centre.

12. We are satisfied that a scheme of federal financial integration on the above lines will not cause any sudden dislocation in the finances of the Travancore-Cochin Union; nor will it necessitate a reversal of any well established and desirable administrative and social policies in these two States. At the same time, it will secure an equitable sharing of the burden of federal financial integration between the Travancore-Cochin Union and the Central Government.

Our suggestions as to the directions in which the Travancore-Cochin Union may develop its financial resources generally and meet the burden arising out of federal financial integration are given below:—

(1) The various "provincial" taxes, fees and duties in these States should be raised gradually to the Madras level. This applies especially to Sales Tax, which has only recently been introduced in Travancore.

(2) The practicability of levying "differential" rates of Sales Tax (*i.e.*, rates higher than the normal) *throughout* the Travancore-Cochin Union upon articles which are now subject to Internal Customs Duties should be investigated, the object being to secure *additional* "Sales Tax" revenue from these articles to an extent which will substantially make good the loss resulting from the abolition of those duties in Travancore.

(3) The problems of Municipal Finance should be immediately tackled. At present there is too much dependence by municipalities upon subventions from the State Governments; this must be reduced to the minimum.

(4) In Travancore, the separation of Agricultural Income Tax from the "Central" non-Agricultural Income-tax will give rise to important financial and other consequences; in the first place, in non-company assessments, there will be a drop in the *effective* rate, and therefore a fall in the yield of Agricultural Income-tax as a result of the separate computation of the Agricultural "total income"; in the second place, there being no Basic Land Tax in Cochin and an altogether differently conceived system of Agricultural Income-tax, there

will arise an anomalous situation born of differential treatment of Agricultural incomes in the two Convenanting States; and thirdly, the total burden of taxation on Agricultural land in Travancore will, as compared with Cochin, be *relatively* less after the merger than it is now.

Three tentative suggestions, each complementary to the other, occur to us;

- (a) To raise the Basic Land Tax in Travancore
At the prevailing level of Agricultural prices this should impose no undue burden; moreover, the reduction in the *effective* rate of Agricultural Income-tax should constitute a further justification for the proposed increase;
- (b) To extend the Agricultural Income-tax *Law* of Cochin (which is simpler than that of Travancore) to the whole Union, the *rates*, however (*i.e.* rates of Agricultural Income-tax and Super Tax) being those now in force in Travancore, and
- (c) in making assessments to Agricultural Income-tax
 - (i) to allow *as Deduction from the "total income"*, the Basic Land Tax in Travancore, and so much only of the Land Revenue in Cochin as would be equal to the Basic Land Tax (at Travancore Rates) had such Tax been in force in Cochin; and
 - (ii) in Cochin only, to allow the difference between the Land Revenue and the Basic Land Tax (had it been in force in Cochin) as credit against the amount payable as Agricultural Income-tax.

It is suggested that these proposals should be carefully investigated. Their effect will be simultaneously to treat Agricultural Incomes in the two Convenanting States on a common-footing for taxation purposes and to bring in additional revenue of a substantial amount.

(5) All social policies, however desirable in themselves, but which would result in immediate increases in expenditure or decreases in revenues, should be held in abeyance. We have especially in mind such matters as extension of prohibition, abolition of zamindari etc. We are fully in sympathy with the natural desire to extend the benefits of these reforms throughout the territories of the Travancore-Cochin Union; but we are equally clear it would be financially *most imprudent* to embark upon them until—

- (a) the immediate financial problems arising out of the merger of the two States have first been satisfactorily solved and the economies to be expected from the resultant administrative integration have been fully achieved;

- (b) the food situation has radically improved; and
- (c) alternative sources of additional revenues have first been fully explored and developed.

Ways and Means

13. Integration of Federal Finances involves the direct credit to the Government of India of all "Central" revenue collections, while the Travancore-Cochin Union would have to finance not only its own current expenditure but also all expenditure on any "Central" subjects entrusted to it for administration on an "agency" basis (until such time as they could be taken over for direct administration by the Government of India themselves). They would also have heavy commitments in respect of food-grains purchases. It would, therefore, be necessary to provide for regular, quarterly, "on account" payments being made by the Government of India, to the Travancore-Cochin Union, based on an estimate of the guaranteed amount *and* food subsidies, etc., that would be payable under the scheme proposed in paragraph 10, *together with* the "Central" expenditure they may have to incur on "agency" basis on behalf of the Central Government.

Privy Purse

14. There is one important matter which must be referred to here. It has been urged before us by the representatives of the Travancore and Cochin Governments that any Privy Purse which might be fixed for the Rulers should be treated as a "Central" item of expenditure in the same way as the "political pensions" now being paid by the Government of India. They have also pressed for similar treatment in regard to certain payments, notably in Travancore State, which are really of the nature of "Privy Purse" sanctioned in favour of Rulers of smaller States which had merged, in the past, into these States.

The Committee do not wish to make any pronouncement on the question whether the Privy Purse should *constitutionally* be a charge on "Central" or on "Provincial" revenues. The Revenue computations made by us in paragraph 9 and the adjustments proposed by us in paragraph 10 have accordingly been evolved on the basis and on the assumption that the Privy Purses would continue to be paid by the Travancore-Cochin Union even after federal financial integration.

If for any special reasons, however, the Government of India should decide that, upon federal financial integration, all States and Unions, (and, therefore, the Travancore-Cochin Union) should be relieved of all responsibility for Privy Purse and that these obligations should be assumed by themselves as a per-

manent addition to their (Central Government's) commitments, our computations relating to the net revenue-gap and the amounts to be guaranteed during the transitional period, (*vide* paragraph 10 *supra*), must be suitably revised; in other words, the amount of the Privy Purse should be added to the expenditure shown in statement II as expenditure to be taken over by the Central Government on federal financial integration, and the computations in paragraph 9, and the proposals in paragraph 10 above, should be revised accordingly. In this way the scheme of transitional financial adjustments proposed by us,—which is based upon a certain appropriateness or “balance” in the distribution of the burden resulting from the integration of the federal finances of the Travancore-Cochin Union,—will be preserved.

IV. CERTAIN SPECIFIC MATTERS RELATING TO "CENTRAL" REVENUE AND EXPENDITURE DEPARTMENTS.

15. Certain matters of general importance connected with the taking over of "Central" functions by the Government of India have been referred to in paragraph 7. Other matters, of purely computational interest, are embodied in the "Notes" accompanying Statements I and II. The comments and observations in this Section of our Report relate to some special problems connected with the taking over by the Central Government of certain specific "Central" Departments.

Specific matters relating to "Central" Revenues.

16. (1) Customs

Cochin Port is already administered by the Government of India; accordingly, on the prescribed date, they will have to take over the administration of customs only at the ports in Travancore.

In our view, no "transitional *limitations*" will be necessary to the application *proprio vigore* of the Indian Sea Customs Act, Import-Export Tariff, and the other relevant Acts, Ordinances and Rules to the Cochin and Travancore States. But necessary steps should be taken to secure legal "continuity of proceedings" in respect of matters done or pending under the Travancore and Cochin Acts on the prescribed date. This will involve—

- (i) extending not merely the legislative but also the executive and administrative competence of the Central Government, and also the judicial authority of its Courts, to the territories of these two States;
- (ii) amending the Sections concerned with the "extent of application" of the aforementioned Indian Acts and Ordinances so as to include the territories of the Cochin and Travancore States; and
- (iii) providing that all matters and proceedings pending under, or arising out of, the pre-existing Cochin and Travancore Acts shall be disposed of under *those* Acts by, so far as may be, the corresponding authorities, of the corresponding *Indian* Acts.

All present arrangements for the pooling and sharing of customs revenue with the Travancore and Cochin Governments will terminate on the prescribed date; and their rights as regards levying customs duties on foreign trade will cease altogether. But there will remain outstanding the division of customs revenue collected at Cochin Port until that date. This question is referred to later in this Report in connection with the allocation of Assets and Liabilities, (*vide* paragraph 22 below).

(2) Corporation tax, Income-tax and Super-tax, other than taxes on Agricultural income

The general position as regards taking over by the Government of India, including the provisions required to ensure legal "continuity of proceedings", will be the same as in regard to Customs. The staff employed wholly or substantially on Income-tax work will have to be separated and taken over by the Government of India in appropriate grades and upon terms not less advantageous than in the service of the States; but every effort should be made to spare such staff as may be required by the two State Governments in connection with their own Sales Tax or Agricultural income-tax work.

Assimilation of State Rates of Taxation to Indian Rates.

We recommend the enactment of suitable "transitional" provisions to provide that the income accruing and arising in Travancore and Cochin up to the prescribed date should, *if not otherwise already taxable in India*, be taxed as follows:—

(a) If 17th August 1949 should be the prescribed date for federal financial integration, then—

- (i) Income, profits and gains of periods which are the "previous year" of Travancore and Cochin assessment years—1124 M. E. and earlier, should be assessed in accordance with the Travancore or Cochin law, and at the Travancore or Cochin rates, respectively, appropriate to the assessment year concerned.
- (ii) Income, profits and gains of all subsequent periods may be assessed according to the *Indian law and rates*; but as respects so much of such income as relates to the period or periods which may be the "previous years" of the Indian assessment years 1949-50 and 1950-51, the *rates* of tax applicable should be those in force in the State concerned on the day preceding the prescribed date

or

(b) If 1st April 1950 should be the prescribed date for federal financial integration, then—

- (i) Income, profits and gains of periods which are the "previous years" of Travancore and Cochin assessment years—1125 M.E. and earlier, should be assessed in accordance with the Travancore or Cochin law, and at the Travancore or Cochin rates, respectively, appropriate to the assessment year concerned.

- (ii) Income, profits and gains of all subsequent periods may be assessed according to the Indian law and rates; but as respects so much of such income as relates to the period or periods which may be the "previous years" of the Indian assessment years 1950-51 and 1951-52, the rates of tax applicable should be those in force in the State concerned on the day preceding the prescribed date.

The above recommendation is based on the conviction that it will be possible to introduce the full Indian rates of tax in the Travancore-Cochin Union, in respect of income arising *after* federal financial integration, in periods which will be the "previous years" for the Indian assessment years 1951-52, or 1952-53, according as the prescribed date may be 17th August 1949, or 1st April 1950, respectively. We see no practical difficulty in doing so. The existing rates in Cochin are already the same as in India. In Travancore, the rates are somewhat lower; but as Income-tax is now assessed there at the average rate applicable to the conjoint total income from agricultural and non-agricultural sources taken together, there is not likely to be any considerable hardship if a switch-over were made in 1951-52 (or 1952-53) to the full Indian rates and to the Indian method of assessment which excludes agricultural income altogether from "total income."

Individual Immunities from Taxation

We recommend that all taxation immunities now enjoyed by (i) Rulers, and (ii) Political pensioners should be protected. A list of such persons, the amounts involved and the exact nature and terms of the immunities enjoyed by them should be furnished by the States to the Central Government. So far as the *Rulers* and their successors are concerned, this recommendation will involve—

- (i) continuance of the immunities from "federal" taxation which they now enjoy in "British India", with the *addition* that their privy purses shall also be totally exempt from taxation (by outright exclusion from "total income");
- (ii) continuance of the immunities from "federal" taxation which they now enjoy in the States, with the *limitation* that such immunities should be restricted to their incomes from such *present* sources only (including properties) as may be declared to be their "Personal and Private Property."

So far as the continuance of their immunity from "provincial" taxation is concerned, the Travancore-Cochin Union will no doubt take appropriate action. As regards *Political pensioners*, our recommendation involves continuance of the immunities from "federal" taxation which they now enjoy in the States,

with the *limitation* that such immunity will extend only during the life-time of the present incumbents, *unless* it be that similar political pensioners in India enjoy a perpetual immunity from "federal" taxation.

With regard to any *Industrial Corporations* now in enjoyment of such immunities, it will be necessary to examine the principal terms of the taxation concessions granted to them. Each case must be dealt with on merits, the general objective being to continue in their favour for some reasonable period, not exceeding 5 years, the existing concessions, if they happen to be more favourable than those admissible under the Indian Income Tax Act itself (*e.g.*, in the case of newly established industrial enterprises).

If the continuance of the immunities referred to above cannot (as we think) be ensured by executive instructions or statutory (exemption) notifications, necessary powers should be taken by appropriate legislation.

State Governments' Immunity from "Federal" Taxation

Industrial and Commercial enterprises wholly owned and operated by these States at present enjoy immunity from "federal" taxation *within* their respective territories. As regards the incomes, if any, accruing or arising to these enterprises within "British India", however, their liability to Indian Income-tax and other federal taxes is governed by the Government Trading Taxation Act, 1926, which provides that they shall be chargeable in respect of such income,

(i) to Income-tax, as if they were "companies";

(ii) to any other tax, as if they were "individuals" or "associations of individuals."

In other words, their position in respect of liability to federal taxation is not dissimilar to that of Provinces under Section 155(1) of the Government of India Act, 1935. If, therefore, federal financial integration in respect of the Travancore-Cochin Union should become effective under the present Government of India Act, no special difficulty will arise, since the present degree of immunity will effectively continue under Section 155(1) of that Act.

But Article 266 of the Draft Constitution will, if enacted, introduce a radical change; it will make the income of such enterprises liable to federal taxation irrespective of the place ("within the territory of India") of its accrual. This is subject only to the very limited exemption contained in the "Explanation" to Article 266. The problem so arising will, however, affect not only the Indian States and Unions, but also the Provinces; and we have no doubt it will accordingly be examined in all its bearings in the Constituent Assembly of India before this Article is enacted into Law. It is not, therefore, necessary (nor, perhaps, would it be proper) for us to express any opinion on the merits of the

proposed Article 266 of the Draft Constitution. But we cannot, however, overlook the fact that if it should be enacted in its present form, it will have adverse consequences upon the finances of Indian States, to the extent that they are now dependent upon the tax-free income from those enterprises; in some States such income is considerable.

Our considered recommendation in this respect is that should Article 266 be enacted in its present form, the *existing* State-owned and operated enterprises should be exempted from federal taxation to the extent to which they *now* enjoy such immunity.

Double Income-tax Relief

Where double-taxation has already occurred, or may (perhaps) inadvertently occur even after federal financial integration, we recommend that relief should continue to be given in accordance with the existing D.I.T. Relief arrangements.

“Remittances”

Under the Indian Income-tax Act, incomes, profits or gains accruing or arising in Indian States are not taxable in India, unless they are received in, remitted to or brought into “British India”, or are *deemed* to have accrued or arisen or been received in “British India”. This position must continue unchanged in respect of transactions upto the date of the merger.

Our suggestions as to the lines on which detailed departmental instructions may be issued by the Central Board of Revenue in regard to this matter are contained in the Annexure to our main Report (Part I).

Excess Profits Tax

This has been abolished in both States; but there are some pending cases under the old E. P. T. Acts. These cases will have to be disposed of by officers of the Government of India, in the same manner as pending cases under the Indian E. P. T. Act. The “Transitional Provisions” required for this purpose, both as to law and rates, will *mutatis mutandis* be similar to those suggested by us for Income-tax.

Capital Gains Tax

We recommend that Capital Gains Tax should not be leviable in respect of any Capital gains accruing in the States prior to the prescribed date.

Business Profits Tax

We recommend that the commencing date of the first “chargeable” period should be the prescribed date.

Income-tax Investigation Commission (Travancore)

This commission should be wound up and the cases referred to it should be transferred to the corresponding Commission in India.

(3) Central Excise Duties

The "taking over" procedure and transitional "continuity" provisions necessary will be the same as under 'Customs'.

We do not consider that there will be any difficulty in the way of introducing the whole range of Indian Central Excise Duties in the Travancore and Cochin States at the full Indian rates.

The present arrangement for pooling and sharing Central Excise Duties will terminate with effect from the prescribed date. The question of division of the revenue collected upto that date is dealt with later on in this Report in connection with the allocation of Assets and Liabilities (vide paragraph 22).

Travancore is at present deriving a substantial revenue from tobacco in the form of —

- (i) Import duty on Jaffna tobacco;
- (ii) Inland customs duty on Coimbatore and Tinnevely Tobacco;
- (iii) Miscellaneous License fees etc., in connection with the sale of tobacco.

The tobacco required for consumption in the State is imported from outside by merchants on their own account by land, sea or rail and removed on payment of duty at the chowkey of import or bonded in the Government "Bankshalls" where it is allowed to remain in the joint custody of the Government and the merchants. The merchants remove the bonded tobacco from the warehouses on payment of duty.

The State will cease to derive any revenue from item (i) with the taking over of foreign customs by the Government of India; and item (ii) will disappear with the complete abolition of internal customs duties which we have recommended elsewhere.

Item (iii) has been assumed by us to be a "Provincial" form of taxation and has been left out of account in our computations.

In Cochin, the entire tobacco consumed in the State is imported from the Indian Dominion. The State is precluded (by an existing agreement) from imposing any duty on tobacco grown in India; but the monopoly right to sell

tobacco within a specific area is auctioned each year to licensees. The entire receipts from this source must clearly be treated as 'provincial', though we are aware that the tax acts as an addition to the Central Excise duties levied by the Government of India in the producing Province (Madras).

The question of entering into arrangements with the Travancore and Cochin States for the total discontinuance of all (or any particular) "Provincial" forms of taxation on tobacco will be a matter for separate negotiation and settlement between the Government of India and the States, on the same lines as in the case of Provinces.

(4) Salt

There is no Salt Duty in either State, but there is some small income in Travancore representing recovery of expenditure incurred in connection with the arrangements for the sale of salt. Income and expenditure on this account has been ignored in our computations. If it should be subsequently decided that the Government of India should take over responsibility for the salt distribution work now done by the Travancore Government, the corresponding receipts will also accrue to the Government of India.

(5) Railways

The Travancore and Cochin State Railways are already worked as part of the Indian State Railway system and no *administrative* problem arises in connection with federal financial integration. We would invite attention in this connection to the remarks against this item in Statement I (Travancore) relating to the recomputation of interest charges on the borrowed capital.

(6) Telephones

The Government of India must take over the Telephone systems on the prescribed date together with all connected assets, liabilities and outstandings in both States.

(7) "Anchal" or State Postal Systems

The Travancore and Cochin Governments are anxious that their "Anchal" system should be continued even after federal financial integration in view of the large extent of rural areas served by it, and its relative cheapness. Our attention was drawn in this connection to the strength of popular feeling in the two States against the curtailment of any of the facilities now afforded by the Anchal Department. The practical suggestion, which we strongly recommend for sympathetic consideration, is that the Indian P. and T. Department, should allow the Travancore-Cochin Union

to work the existing Anchal services on an "agency" basis, even though for financial and budgetary control purposes, "Anchal" would have to be treated as a "Central" subject as from the prescribed date.

We realise that this proposal will require careful consideration by the Government of India. We would in any case strongly urge that in the event of a decision being taken to merge the Anchal into the Indian P. and T. Department, every effort should be made to maintain all the existing postal facilities in villages now served by the Anchal.

It will be convenient to refer here to the Anchal "Savings Bank" which is at present worked by the Travancore and Cochin Governments and has been of considerable assistance to them for their "Ways and Means" purposes. If the 'Anchal' Service is amalgamated with the Indian Posts and Telegraphs Department, there is no doubt that the Savings Bank must also be taken over by that Department and administered in accordance with the rules and regulations of the Central Government. In that case, the entire outstanding liability to depositors will have to be assumed by the Government of India, subject to necessary adjustments which are discussed in the section dealing with Assets and Liabilities.

If, however, it should be found possible to continue the Anchal as a separate entity for a period of years, operated through the "agency" of the Travancore-Cochin Union, we would recommend the continuance, under the control of the Travancore and Cochin Governments, of the Anchal Savings Bank also, subject, however, to the gradual reduction of the rate of interest to the rate allowed by the Indian Postal Savings Bank. We would also recommend in that event, the continuance of "tax-free" concession in respect of interest paid by the Anchal Savings Bank.

(8) Currency

(a) In Travancore, there is a local currency known as the "Sircar Rupee" (not actually in circulation) together with subsidiary small coins of various denominations in free circulation throughout the State. There is no Paper Currency in Travancore, nor any local currency at all in Cochin. The official rate of exchange of the Travancore Currency is 56 Indian Rupees to 57 Sircar Rupees.

Upon federal financial integration, the Travancore "Currency and Mint" will have to be taken over by the Government of India, together with all the assets, outstandings and liabilities connected therewith, including all stocks of bullion, base metal and unissued coins at the Mint (at their bullion or base metal value). Further issues of this currency should be discontinued; and Indian Rupees and subsidiary coins made legal tender throughout the

territories of Travancore, if they are not already so. The Travancore Rupee and subsidiary coins need *not*, however, be demonetised immediately; they may, in fact, be allowed to continue to circulate freely and accepted at all Government Treasuries in Travancore at the present rate of exchange. Any local currency so received at Treasuries should not be re-issued, Government payments being always made in Indian Rupees and subsidiary coins which should be supplied freely by the Reserve Bank of India or its agents at the official rate of exchange to all parties, including the Travancore Government, or the Government of the Travancore-Cochin Union.

(b) The quantities of Travancore coins in stock and in circulation are reported to be as follows:—

Particulars	Face Value Rs. (lakhs)	Bullion or metal value Rs. (lakhs)
Silver Coins	44.14	13.10
Copper Coins	29.32	7.13

When, in accordance with the procedure suggested above, a substantial part of the coinage in circulation has been withdrawn in due course, the question of demonetising this currency may be taken up in consultation with the Reserve Bank of India.

The loss involved during the process of gradual withdrawal of the Travancore currency and upon its ultimate demonetisation should be borne by the Government of India, as a capital loss of a "Central" character resulting from federal financial integration; some part of this loss will probably be recouped by way of profit on the issue of Indian subsidiary coins in replacement of the Travancore coins as and when withdrawn.

(c) For the purposes of this Report, we have throughout worked on the figures as given in the accounts of the Travancore Government; these figures are in terms of Travancore Sircar rupees. Strictly speaking, the amounts of revenue and expenditure for the basic period (and consequently the figure of the *net* revenue-gap) relating to Travancore State, must be converted into Indian currency at the prescribed rate of exchange. It has, however, been explained to us that the Travancore Government have under consideration a proposal according to which the existing rates in respect of taxes and other payments to Government would, as from the date of integration with Cochin, be expressed in Indian currency as if one Sircar rupee were equivalent to one Indian rupee. If this proposal is ultimately adopted, we recommend that for the purpose of working out the *net* revenue-gap, the financial adjustments on Revenue account during the transitional period, and the adjustments on account of assets and liabilities, no adjustment need be made for the fact that the figures are expressed in Travancore Sircar rupees; that is to say, all our computations may, in that event, be taken as if they were already expressed in Indian Rupees.

Specific matters relating to "Central" expenditure

17. (1) **National Highways**

According to the latest information furnished by the Ministry of Transport, Government of India, a road mileage of 207 in Travancore and 75 in Cochin is likely to be declared as "National Highways". This figure has accordingly been adopted for computational purposes. The average annual expenditure on National Highways to be met from Revenue may be taken as Rs. 3,000 a mile, inclusive of normal expenditure on improvements in addition to ordinary maintenance.

We understand that the Government of India propose to meet one half of the expenditure on *new* roads declared as National Highways and also intend contributing a further equivalent amount in the form of grants-in-aid for the maintenance and development of *other* roads in the States concerned. The net effect will be that the Centre will be meeting the full cost of the maintenance and development of all National Highways.

Future *capital* expenditure on National Highways will be separate and cannot be taken into account for purposes of working out the net revenue-gap or the consequential adjustments required, in connection with federal financial integration.

(2) **Defence**

After financial integration, the Central Government must take over all I.S.F. Units in the two States (i.e. all Units of the "Indian State Forces", properly so called) as a "going concern" together with all establishments, installations and equipment, including all assets, outstandings, liabilities and Funds connected with them. This recommendation should not of course be construed as necessarily precluding the continuance of the present arrangement for the *administration* of these Units through the Rulers of the two States or the Rajpramukh of the Travancore-Cochin Union.

(3) **Pensions**

The pensionary liability in respect of I.S.F. military personnel and "Central" Civil Department personnel who may have retired before the date of integration, will devolve on the Centre as the "Successor" Government in all "Central" matters. From a practical point of view, however, it will serve no useful purpose to disturb the existing arrangements in the States for such payments. We therefore recommend that these payments (a complete list of which should be compiled as on the date of integration), should continue to be paid by the Travancore-Cochin Union on account of the Government of India. Pensions in respect of retirements on or after the date of integration will however, be payable in the ordinary way by the Government of India.

(4) Audit and Accounts

The Travancore and Cochin Governments desire that their Audit and Accounts department should continue to be administered by them for a transitional period after which arrangements can be made for the transfer of the responsibility to the Centre. Consequently, for the purpose of working out the integration financial adjustments, expenditure on the audit and accounts departments must continue to be treated as a "provincial" charge, with the exception of a portion relating to "federal" transactions, which would be met by the Centre. This has, therefore, been entered in Statement II, as expenditure to be taken over by the Government of India upon financial integration.

If, at a future date, it should be decided that, the Government of India should, as in the case of provinces, take over responsibility for audit and accounts, the computations should be suitably revised, so as to include the expenditure of this Department in Statement II for both States.

So long as the audit and accounts arrangements continue to be under the control of the State Governments they will have to comply with such directions as the Auditor-General of India may find it necessary to give for the purpose of discharging his statutory responsibilities under Sections 167 and 168 of the Government of India Act, 1935, and under the corresponding provisions in the new Constitution of India.

(5) Transitional Provisions

In connection with some, if not all, "Central" Departments referred to in this paragraph, "transitional" provisions will be necessary to ensure "legal continuity" of proceedings pending under the relevant State legislation as on the date of integration.

V. ASSETS AND LIABILITIES

Classification of Assets and Liabilities

18. The basic principles to be followed in the matter of allocation and apportionment of assets and liabilities have already been outlined in paragraphs 3 and 7 of this report. The detailed plan is explained below. For this purpose, assets and liabilities have to be considered under the following categories:

(1) Assets:

(a) *Specific Capital Assets*, i.e. Specific assets of a more or less durable character, consisting of:—

(i) Unproductive Assets i.e. not capable of yielding any revenue; and

(ii) Productive Assets i.e. yielding (or capable of yielding) revenue.

Any "specific debt" connected with these assets will go with them, and should be taken in reduction of their book values.

(b) *Current Assets* such as Cash and Bank Balance, investments etc. i.e. liquid assets, essentially of a "banking" character.

(2) Liabilities:

(a) *Current or Banking Liabilities* which are of the nature of current obligations to "outsiders", (e.g. Bank over-drafts, Savings Bank Deposits, Provident Fund Deposits, Insurance Funds, Sinking Funds, Trustee Liabilities etc.).

(b) Liabilities in respect of various *Funds and Reserves*.

(c) *Permanent Debt* i.e. Public debt other than "specific debt" referred to above in connection with capital assets.

The actual allocation of assets and liabilities between the Central and the two State Governments will have to be made with reference to the accounts figures as at the date of federal financial integration. For purely illustrative purposes, however, the book values of assets and liabilities of the Travancore and Cochin States as at the end of their financial year 1123 M.E. have been adopted in the following paragraphs.

Specific Capital Assets

19. "Productive" and "unproductive" specific capital assets, together with the "specific debt" if any associated with them, must be allocated to the Central Government or to the Travancore and Cochin Governments on a functional

basis, that is to say, such of these assets as may be connected with "Central" functions and revenues should go to the Central Government and the rest to the respective State Governments. The actual taking over of "Central" assets by the Government of India will be as follows:—

(1) 'Un-Productive' Capital Assets:

As already stated no account can be prepared of such assets nor is it necessary to do so. The Central Government will take over by inventory all unproductive capital assets connected with 'Central' functions or 'Central' revenues. The Travancore and Cochin states will retain the rest.

(2) 'Productive' Capital Assets:

(a) The Government of India will take over all specific productive capital assets connected with 'Central' functions. These are:—

As at the end of 1123 M. E. (1947-48)		
	Travancore Rs. (in lakhs)	Cochin
1. Railways	144.40 86.20	117.97
2. Telephones	27.23	..
3. Broadcasting	2.43	..
4. Mint	1.20	..
5. Harbour Development Ex- penditure—		
(Travancore's share)	0.78	..
	262.24	117.97
Less Specific Debt (Railways)	144.40	70.00
	117.84	47.97

The "specific debt" of Rs. 144.40 lakhs in the case of Travancore represents the amount advanced by the Government of India towards Railway construction in Travancore. The "taking over this debt" by the Central Government will mean that the amount owing by Travancore must be written off the Government of India's books.

(b) The Travancore and Cochin States will retain all 'productive' capital assets connected with 'provincial' functions. These are:—

	As at the end of 1123 M. E. (1947-48)	
	Travancore	Cochin
	Rs. (in lakhs)	
Electric Schemes	*480·14	65·26
State Transport <i>less</i> depreciation	14·64	..
Coastal Transport	5·97	3·47
Productive Irrigation Works	81·34	4·80
Government Industrial Concerns	27·22	5·02
Navigation Canals . . . . .	..	40·17
Investment in Harbour Reclamation . . . . .	..	15·93
Town Improvement Works . . . . .	..	36·98
Long-term Loans for Provincial purposes . . . . .	..	2·40
TOTAL	609·31	174·03
<i>Deduct Specific Debt (amount so far spent by Cochin out of Rs. 100 lakhs loan for Hydro-Electric Schemes)</i>	<i>..</i>	<i>30·00</i>
GRAND TOTAL	609·31	144·03

Liquid Assets, and Current Liabilities, Reserves and Funds

20. We now turn to the allocation of the current or "banking" assets, and current liabilities, Funds and Reserves in accordance with the general principles indicated in paragraph 7 of this Report.

In the first place, the Government of India must be allotted such of the liabilities, Funds and Reserves as would, upon federal financial integration, be functionally theirs; the rest will remain with the Travancore and Cochin Governments. At the end of the State financial year 1123 M.E. these liabilities, Funds and Reserves stood as follows (*vide* Statement III for a complete analysis):

Sec- tion	Particulars	Travancore		Cochin	
		Central	"Others" "Total"	Central	"Others" "Total"
		Rs. (in lakhs)			
A.	Banking or current liabilities, Trust Funds, Sinking Fund etc.	33·61	1206·21 1239·82 (plus ?)	..	333·37 333·37

*Less depreciation.

Section	Particulars	Travancore			Cochin		
		Central	"Others"	"Total"	Central	"Others"	"Total"
B.	Specific ("Functional") Funds.	..	120·15	120·15	..	12·92	12·92
C.	(i) Depreciation Funds	..	*	..	..	..	..
	(ii) Asset Reserve Fund.	..	22·56	22·56	..	2·00	2·00
	(iii) Post-War Funds	..	524·07	524·07@	..	7·91	7·91@
D.	Open or General Reserves.	..	75·30	75·30@	..	61·75	61·75@
E.	Public Debt, other than "Specific Debt" ** (Less Sinking Fund)	..	348·25	348·25	..	33·58	33·58
	TOTAL . . .	33·61	2296·54	2330·15	..	451·53	451·53
			(plus?)				

Notes.—*taken in reduction of the book value of the capital assets concerned, as current assets are insufficient to meet liabilities.

@ No part of these Funds and Reserves is allotted to the Centre, as current assets are insufficient to cover them by a substantial amount.

** "Specific Debt" has been taken into account in paragraph 17.

A careful study of the analysis of these figures in Statement III shows that very few of the above liabilities or Funds can be classified as "Central". The "Savings Banks Deposits" included among Banking liabilities (in group 'A' above) will become a "Central" liability if the "Anchal" should be taken over by the P. & T. Department and so abolished as a separate organisation run by the States themselves. Similarly, a portion of the Provident Fund balances will also have to be transferred to the Government of India, along with the personnel taken over in connection with the administration of "Central" subjects; and some of the Departmental and other Deposits may be of a "Central" character.

Financially, the allocation of any item of current liability to the Government of India or to the Travancore and Cochin Governments, together with an equivalent allocation of liquid assets to meet such liabilities, should not present any difficulty to the extent to which "current assets" were in fact available for allocation to either Government along with an equivalent amount of current liabilities. If however, (as in the case of these two states), there should be an excess of liabilities over 'current' assets, such excess must be equitably apportioned between the two Governments. This problem is dealt with in the next paragraph.

Treatment of Excess of Liabilities and Public Debt Over 'Current' Assets

21. I. Travancore.

(i) The total liquid assets available at the end of 1123 M.E. amounted to Rs. 1,680.94 lakhs as follows:—(*Vide* Statement IV for a complete analysis).

	Rs. (Lakhs)
Cash and Bullion	2.65
Bank Deposits	68.70
Shares & Investments	1045.89
Loans and Advances	418.18
Miscellaneous	145.52
	1680.94

The liquid assets were sufficient to meet *in full* only the following out of the liabilities and Funds of this State set out in the preceding paragraph:—

	Rs. (Lakhs)
Section A—Banking Liabilities	1239.82
Section B—Specific Funds	120.15
Section C—Reserve Funds (for Capital Assets)	22.56
Section D—Reserves (<i>Invested</i>)	75.30
	1457.83

Utilising the remainder of the Current Assets, *i.e.*, Rs. (1,680.94 *less* 1,457.83) lakhs = Rs 223.11 lakhs for the Post-War Funds, there is left over an "uncovered liability", wholly in respect of those Funds, amounting to Rs. 300.96 lakhs. In addition to this, there was a (net) uncovered Public Debt amounting to Rs 348.25 lakhs. It now remains for us to suggest how these two uncovered liabilities should be dealt with.

(ii) The uncovered Liability in respect of Post-War Funds is a mere "book" liability of a character which should be sharply distinguished from liabilities owing to *outsiders* in respect of moneys (or benefits) "had and received". The former is not a debt due to anyone; the latter is. The true nature of a liability in respect of a Fund of this description is a *liability to incur expenditure* (a) for the purposes for which the Fund was created, and (b) to the extent to which assets are in fact available. When assets are *not* available, the Fund must be regarded as exhausted or extinguished to that extent. But even if this last

point were ignored, on the ground that assets *must* have existed when the Fund was created and that, to the extent of the present shortage, they must have been *properly* spent (*e.g.*, by being spent on unproductive assets, both "Central" and "provincial") though not accounted for as such, then clearly the matter is merely one of wrong accounting, which can now be rectified by tracing back the expenditure so incurred and writing it off against the "uncovered" balance of the Fund. There will then be no "uncovered" balance to be "allocated"; and nothing more will remain to be done since, on the principles already stated, there can be no question of the Central Government having to *pay* anything for any unproductive "Central" assets allocable to them on a functional basis.

There is, therefore, no "allocation" to be made in respect of this uncovered "liability"; and no actual financial adjustments need accordingly be made between the Central Government and Travancore on this account.

(iii) *Public Debt*.—The only remaining item to be considered is the *net* Public Debt, which amounted to Rs. 348.25 lakhs, (after deducting the Sinking Fund provision already made). The Central Government must accept a share of this liability. We recommend that their share should be worked out in proportion to the net book value of the specific *productive* capital assets allotted to them and the Travancore Government respectively.

In this connection a suggestion was made by the representatives of the Travancore Government, at our joint meeting with them and with the representatives of the Cochin Government, that for the purpose of determining the ratio for the division of the Public Debt as above, an addition should be made to the productive Capital Assets for the value of the *unproductive* assets taken over by each Government *to the extent of the uncovered balance* in the Post-War Funds. For this purpose, the Travancore Government would furnish information regarding unproductive "Central" and "Provincial" assets acquired over the period during which the funds have been in existence.

We were at first inclined to accept this suggestion; but on further careful examination of its full implications, we regret we are unable to do so, as we consider it altogether wrong in principle. In the first place, we regard the uncovered balance in the Post-War Funds as altogether irrelevant to this issue; secondly, even that uncovered balance is, in our opinion, the result *either* of assets of the Fund having been already spent for current revenue purposes, in which case the Fund must be treated as having been exhausted on purposes other than those for which it was intended, *or* of incorrect accounting in respect of expenditure properly incurred from the Fund, in which case the correct remedy would be to rectify the error by writing off such expenditure against the so-called "uncovered" balance of the Fund, whereupon there will be no such balance left to argue about.

Thirdly, the method suggested has really the effect, indirectly, of requiring the Central Government to *pay* for unproductive assets, which, it is already agreed, would be incorrect in principle. We conclude therefore that no modification can be accepted to the formula suggested by us for the apportionment of the uncovered Public Debt between the two Governments.

II. Cochin.

The total liquid assets available at the end of 1123 M.E. amounted to Rs. 381.92 lakhs as follows:—

	Rs. (Lakhs)
Cash and Bank Balances	39.52
Bank Deposits	37.50
Shares & Investments	106.01
Loans & Advances	47.02
Miscellaneous	151.87
	381.92

These assets were sufficient to cover *fully* all banking or current liabilities, Specific (functional) Funds, Reserve Fund against Capital Assets, and Post-War Reconstruction Fund. After providing for these liabilities, the surplus of current assets left over was only Rs. 25.72 lakhs. This small surplus is likely to disappear by the end of 1124 M.E., when there may even exist an excess of current liabilities over liquid assets if the present drain on the State's resources caused by the food situation should continue as at present.

We proceed, therefore, on the basis that on the date of federal financial integration we should have to reckon with (a) uncovered Funds and Reserves (at least Rs. 61.75 lakhs) and (b) uncovered Public Debt (Rs. 70 lakhs) *less* Sinking Fund (Rs. 36.42 lakhs). The allocation of these uncovered liabilities between the Central Government and Cochin should be made on exactly the same principles as explained above for Travancore; that is to say, the general reserves (which are not specifically invested) must be treated as having been exhausted, and the Public Debt, together with any excess of current liabilities (due to outsiders) over liquid assets, should be apportioned between the Central Government and Cochin in proportion to the net book value of the specific *productive* Capital Assets allocated to each.

22. (1) Outstanding Obligations and Revenues, not shown in accounts

All running, or "continuing" liabilities and outstandings in each "Central" Department (whether on Capital or Revenue account) must be taken over by the Government of India. They will consist of all outstanding claims for and against

Government including refund claims, pending bills for supplies, stores, contracts, services and contingencies etc., and all uncollected "Central" revenues, whether assessed or not. In view of the "cash basis" of accounting followed in Government Departments, there will ordinarily be no "account" balances to be brought on to the books of the Government of India in respect of these items; but an inventory, so far as possible, should be prepared by each Department at the time of taking over.

With regard to accrued Capital expenditure on specific Productive Assets, such expenditure, even when subsequently paid by the *Central* Government (in respect of 'Federal' assets) in accordance with the foregoing recommendation, or by the Travancore-Cochin Union (in respect of "Provincial" assets), should be taken into account in the book valuation of these assets as on the date of financial integration.

(2) Inter-Governmental outstandings accrued and due, but not settled, by the prescribed date (Travancore and Cochin).

The list of liabilities set out in Statement III does not also include certain important items of *current* inter-Governmental outstandings. Thus the entire Central Excise collections have been taken to the credit of Travancore revenues without keeping any portion in suspense for payment to the Government of India upon final settlement of their claim. Likewise, the share of Customs revenue from Cochin Port, net receipts from Railways, etc., which have accrued but have not yet been paid by the Government of India, have not been included in the statement of assets. There may be several other items of this kind which, though not important individually, may amount in the aggregate to a substantial sum. Outstanding items of this nature clearly fall in a different category from "unaccounted" arrears of revenue and pending obligations to outsiders; and we recommend that all inter-Governmental claims *in respect of transactions upto the prescribed date* (whether accounted for or not) should be settled, in due course, by cash payment on either side, notwithstanding the coming into force of the federal financial integration scheme.

Miscellaneous matters connected with assets and liabilities

23. The following important points arise in connection with some of the individual items of assets and liabilities:—

(1) State Savings Bank Deposits (Travancore and Cochin)

The Savings Bank is operated through the Anchal Department, and therefore corresponds to the Indian Post Office Savings Bank. It will have to be taken over by the Central Government in the event of the Anchal itself being

abolished and replaced by the normal postal services under the Indian P. & T. Department. In that case, it will be necessary for the Centre to take over an amount of current assets equal to the outstanding liability on the prescribed date. As the sudden withdrawal of a large amount of current assets in this way will, however, almost certainly embarrass the State Governments seriously from a "ways & means" point of view, it will be best for the Central Government to treat the amount as an advance to them at the average rate at which it was borrowed.

If, however, the Government of India decide to permit the continuance of the Anchal as a separate service, to be worked by the Travancore and Cochin Governments for a period of years on an 'agency' basis, we recommend that the Central Government should also postpone the taking over of the Savings Bank until the Anchal is itself fully absorbed. A reference is invited in this connection to our remarks in paragraph 16(7).

(2) State Life Insurance Fund, Accident Insurance Fund (Travancore and Cochin), and Transport Insurance Fund (Travancore)

The continuance of the Insurance Funds is not directly covered by any entry in the "federal" list of subjects in the Draft Constitution. There appears to be no need, therefore, to allocate the Funds to the Central Government. There is no reason why the Travancore and Cochin Governments should not carry on these business activities in the same way as any Insurance Company.

(3) Provident Funds (Travancore and Cochin)

No portion of the Provident Fund amounts shown in Statement III has been classified as "Central". Actually, so much of the Provident Fund balances as may relate to the staff to be taken over by the Central Government will have to be separated and transferred to the Government of India. It should not be difficult to collect the required particulars as soon as possible after the date of federal financial integration. The rest of the Provident Fund balances will continue on the books of the Travancore and Cochin States.

It is important that each account should be complete in all respects including interest credits on the prescribed date.

(4) Post-War Services Reconstruction Fund

This must be taken over by the Central Government.

(5) Balances under Remittance and Suspense

It is obviously impossible to allocate this balance until "cleared" by transfers to appropriate accounts when full particulars are known. When so "cleared", the sorting between "Provincial" and "Central" will be automatically achieved on a functional basis. For the present, it is assumed that the entire balance is "Provincial".

(6) Departmental and Other Deposits

These will have to be sorted out in detail and allocated functionally between the Central and State Governments.

(7) Tax Free Loans

The "tax-free" rights attached to any Public Loans of these States outstanding at the prescribed date should be continued by the Central Government.

Banking and Treasury Arrangements

24. With the taking over by the Central Government of the responsibility for direct administration of departments connected with Central revenues and Central services, it will be necessary to extend to the Travancore and Cochin States the Rules and Regulations connected with Banking and Treasury procedure of the Central Government in so far as the transactions of the "Central" departments are concerned. It would also be desirable that the banking and treasury arrangements of the States themselves in respect of "Provincial" transactions should fall in line with the system prevailing in Provinces. We have not examined this aspect of the matter in detail, as the State Governments represented that their existing arrangements were adequate and working smoothly, and desired to postpone consideration of this question until some time after the introduction of federal financial integration. We recommend that their request should be examined sympathetically.

Borrowing Powers

25. Immediately upon the introduction of federal financial integration, the borrowing powers of the Travancore and Cochin Governments will be regulated by the same Constitutional provisions as are applicable to provinces—*vide* Section 163 of the Government of India Act 1935 (as amended), and Article 269 of the Draft Constitution.

VI. SUMMARY OF RECOMMENDATIONS

26. Our principal conclusions and recommendations are summarised below.

(1) Terms of Reference

Our first and fifth terms of reference involving a detailed enquiry in the field of "Provincial Finance" of Indian States and Unions having been withdrawn, as proposed by us, we have confined our attention to the other terms of reference relating to the problem of federal financial integration of Travancore and Cochin, and the consequential financial adjustments required over a transitional period between the Governments of the two States on the one hand and the Government of India on the other. (Para. 1).

(2) General Line of Approach

We have discussed the constitutional basis for integration of Federal Finance, and elucidated the principles involved. In our view no question of paying any "compensation" can arise; but a balanced scheme of financial adjustments over a transitional period will be necessary for avoiding financial dislocation. (Para 3).

(3) Constitutional Requirements

We recommend that—

- (i) federal financial integration should be preceded by complete "accession" on all subjects in Lists I and III including Finance and taxation matters;
- (ii) transitional financial adjustments should terminate after a maximum period of 10 or 15 years as may be provided by Article 258 of the Draft Constitution;
- (iii) all Customs Duties on internal trade, *i.e.* on trade with the rest of India should be abolished as soon as the integration of the federal finances of these States becomes effective. (Para. 5).

(4) Date of Federal Financial Integration

Ordinarily, federal financial integration should be effective from 1st April 1950; but the State Governments would be willing to make it effective from 17th August 1949 under the present Government of India Act. We recommend accordingly. (Para. 6).

(5) Practical Consequences

We have outlined the practical consequences of applying the principles underlying federal financial integration, to the revenues and expenditure, and the Assets and Liabilities of the two States. (Para. 7).

(6) "Revenue-Gap" arising out of Federal Financial Integration

(i) The *net* Revenue loss to the Travancore and Cochin States, taken together, upon federal financial integration (on the basis of figures for their financial year 1123 M.E.) would be Rs. 330 lakhs; this includes a *net* loss of Rs. 100 lakhs by abolition of internal Customs Duties in Travancore State. (Para. 9).

(ii) We recommend that—

(a) the loss resulting from the immediate abolition of Internal Customs Duties of Travancore must be borne by the State Government;

(b) as regards the residual *net* "Central" Revenue-Gap of the two States taken together (Rs. 230 lakhs), there should be a guaranteed reimbursement by the Central Government to the following extent during a transitional period:—

From the date of federal financial integration Rs. 230 lakhs per annum to 31st March 1955.

From 1st April 1955 to 31st March 1960 .	the residual <i>net</i> Revenue-gap of Travancore in full (<i>i.e.</i> , Rs. 127 lakhs) <i>plus</i> a gradually reducing part of the Cochin net revenue gap of Rs. 103 lakhs, so as to work it down to 60 per cent thereof in 1959-60.
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The amount payable in 1959-60 will continue to be paid as a guaranteed re-imbusement for a further period of 5 years, if the Constituent Assembly should accept an extension of the transitional period to 15 years (under Article 258).

(iii) the above guarantee should be implemented by the Central Government by paying to the States—

(a) their share of income tax and other divisible Federal taxes, computed on the same basis and principles as are applicable to Provinces; and

- (b) an additional grant-in-aid to the extent to which the share of divisible taxes under (a) should fall short of the total guaranteed amount.

If in any year the State Governments' share of divisible Federal taxes should exceed the guaranteed amount, they will be entitled to the larger sum.

(iv) the State Governments should be entitled to all forms of financial and other assistance from the Central Government in exactly the same way as Provinces, *in addition to the amounts guaranteed as above.* (Para. 10 (1) to (4).)

(7) Our scheme does not preclude the State Governments from approaching the Government of India for financial assistance on the merits of the case, with reference to their initial difficulties arising out of the *merger* of the two States as distinct from the *net* Revenue loss arising from federal financial integration (Para. 10(5).)

(8) We have explained how the above scheme would make possible the immediate abolition of Internal Customs Duties without financial dislocation. (Para. 11(1)).

(9) We have explained the considerations which we have kept in view in making our recommendations. (Para. 11).

(10) We have offered some suggestions as to the directions in which the State Governments might develop their resources not only to meet their share of the burden arising from federal financial integration, but also to improve their finances generally. (Para. 12).

(11) We have recommended *quarterly* 'on account' payments of the various amounts due to the State Governments under our scheme; this will save them from the embarrassment which would otherwise result in their "Ways and Means" position after federal financial integration. (Para. 13).

(12) "Privy Purse"

Our proposals have been evolved on the basis that "Privy Purse" will not be a Central liability. If, however, "Privy Purse" should, for any reason, be made payable out of Central revenues, our computations of the net revenue-gap resulting from federal financial integration and of the amounts guaranteed during the transition period will require consequential revision. (Para. 14).

(13) Specific Matters connected with Revenue and Expenditure Departments

We have made several detailed recommendations concerning certain specific matters relating to items of "Central" revenue and expenditure Departments, and concerning the taking over of the respective Departments and staff by the Government of India; those relating to income-tax are important. We have also dealt with the question of continuance of the "Anchal" (postal) system and the problem of replacing Travancore local currency by Indian currency. (Paras. 15-17).

(14) Assets and Liabilities: (Paras. 18-21).

(i) The Central Government should take over unproductive capital assets connected with Central functions or Revenues, by inventory, *without valuation*. The Travancore and Cochin States will retain the rest of the unproductive capital assets.

(ii) "Productive" Capital assets connected with "Central" functions should similarly be taken over by the Government of India along with the "specific debt" associated with such assets. The *net* book value of such assets as at the end of 1123 M.E. was Rs. 118 lakhs and Rs. 48 lakhs in the Travancore and Cochin States, respectively.

(iii) Productive Capital assets connected with "Provincial" functions along with the specific debt" attached thereto, should be retained by the State Governments. Their value on the date mentioned was Rs. 609 lakhs and Rs. 144 lakhs, in Travancore and Cochin respectively.

(iv) We have given an analysis of the current liabilities, Reserves and Funds of the two States and have drawn up a scheme according to which—

- (a) the Government of India and the State Governments will each receive current or liquid assets to the extent available to meet the liabilities or Funds assigned to them on a functional basis;
- (b) any portion of the Funds or Reserves not covered by liquid assets would be regarded as extinguished to that extent;
- (c) the *net* Public Debt and liabilities to outsiders, not covered by liquid assets, would be shared by the Central Government and the State Governments in proportion to the *net* value of the specific productive Capital assets allocated to each.

(v) Although we have illustrated our scheme of allocation and apportionment of Assets and Liabilities with reference to the figures as at the end of 1123 M.E., the actual adjustments to be made in due course will be based on the book values of Assets and Liabilities as at the date of federal financial integration.

(15) We have recommended that the Government of India should take over all running or "continuing" liabilities and outstandings including "arrears" of Revenue in each "Central" department not shown in the accounts; but inter-Governmental outstandings (whether accounted for or not) as at the date of federal financial integration should be settled in due course by cash payment on either side. (Para. 22).

(16) We have offered some suggestions on certain miscellaneous matters connected with Assets and Liabilities such as the States Savings Bank Deposits, State Insurance Funds, Provident Funds, etc. (Paras. 23-25).

27. This Report is not signed by Shri Patil as he is out of India at present; but all the important issues have been discussed with him and the conclusions reached have his full concurrence.

V. T. KRISHNAMACHARI,

Chairman.

G. SWAMINATHAN,

Secretary.

N. DANDEKER,

Member.

Hyderabad House,
New Delhi, dated 10th June 1949.

STATEMENT I—TRAVANCORE

Particulars of revenues which will be lost to the State as a result of Federal Financial Integration

Section & Serial No.	Particulars	Amount (Rs. in lakhs)		Refer- ences to foot- notes
		1122 ME	1123 ME	
SECTION A				
<i>"Central" revenues which will merge with the revenues of the Government of India.</i>				
1.	Customs duties on foreign trade	32.03	50.13	(1)
2.	Corporation Tax	15.75	15.60	(2)
3.	Income-tax (other than agricultural Income-tax and Corporation tax)	71.18	84.10	(3)
4.	Central Excise	24.14	25.81	(4)
5.	Railways "Net Receipts"	6.25	10.48	(5)
6.	State Postal Department ("Anchal") "Net Receipts"	1.38	—0.50	
7.	Telephones. "Net Receipts"	2.91	1.05	
8.	Currency and Mint "Net Receipts"	1.94	..	
9.	Miscellaneous (Interest on Federal Investments) . . . . .	..	..	(6)
Total of Section A		155.53	186.67	
SECTION B				
<i>Taxes which will be abolished on financial integration.</i>				
10.	Salt . . . . .	..	..
11.	Import—Export duties on Indian (Internal) trade	96.76	103.02	
Total of Section B.		96.76	103.02	
GRAND TOTAL		252.34	289.69	

TRAVANCORE

Notes relating to statement I

(1) Customs duties on foreign trade

The figure appropriate to the years has been extracted on a reclassification of the total revenue under Customs and Excise, keeping in view the necessity for allocation between 'Foreign trade' and 'Indian trade'.

(2) Corporation Tax

The revenue under Corporation Tax has not been separately shown in the published accounts. The figure has been extracted, however, from the total revenue, which has been reclassified for the purpose as below under suitable heads consistently with the object in view:—

	Rupees in lakhs	
	1122 M.E.	1123 M.E.
Excess Profits Tax	35·28	8·70
Agricultural Income-tax	55·45	62·00
Agricultural Corporation tax	12·25*	12·40
Agricultural Super Tax . . . . .	..	3·50
Ordinary Corporation Tax	15·75	15·60
Income-tax, Super-tax from individuals, etc. (non-agricultural)	71·27	84·10
	190·00	186·30

(*Includes Rs. 0.09 lakhs Agricultural super tax on Individuals.)

(3) Income-tax

An addition should be made to the figure for Income-tax receipts in the basic period to allow for the increase which would have resulted if E.P.T. had not been allowed as a deduction from the total income.

(4) Central Excise

The figures have been computed after excluding the 'Customs' and 'Provincial Excise' elements.

The figures taken into account should be modified if Travancore's share of any Central Excise duties is ultimately fixed at a different figure, after final settlement with the Government of India.

(5) Railways

The State's Railway income is based on payment of Interest at $5\frac{1}{2}$ per cent. on the amount borrowed, *viz.*, Rs. 107.84 lakhs. This amount was originally borrowed at $3\frac{1}{2}$ per cent. from the Secretary of State for India but when converted into Rupee Loan and transferred to the South Indian Railway and then finally to the Government of India, the rate was increased to $5\frac{1}{2}$ per cent. The State's income has, therefore, been recomputed on the basis of $3\frac{1}{2}$ per cent. on the amount borrowed against $5\frac{1}{2}$ per cent. and an addition of Rs. 2.15 lakhs has been made to the net receipts as booked in the accounts. This adjustment has been accepted by the Committee, without prejudice to the case of either the Government of India or of Travancore in respect of re-adjustment of past accounts.

(6) Interest

Interest on investments which may ultimately be taken over by the Central Government, *less* interest on liabilities which may ultimately be taken over by the Central Government will have to be entered against item 9 of Statement I.

STATEMENT I—COCHIN

Particulars of revenues of Cochin which will be lost to the State as a result of Federal Financial Integration

Serial No.	Particulars	Actual Receipts (Rs. in lakhs)		Ref. to Foot- notes
		1122 ME (46-47)	1123 ME (47-48)	
<i>A. "Central" Revenues which will merge with the Revenues of the Government of India.</i>				
1.	Customs duties on Foreign trade, (Cochin's share of <i>net</i> receipts under the Cochin Harbour Agreement)	31.31	55.73	(1)
2.	Corporation Tax	7.54	5.14	(2)
3.	Income-tax and Super-tax (Other than Corporation Tax and Agricultural Income-tax)	30.09	39.41	
4.	Central Excise	3.85	3.85	(3)
5.	Railways—"Net Receipts"	8.21	12.76	(4)
6.	Postal—Anchal—"Net Receipts"	1.06	0.66	
7.	Telephones—"Net Receipts"	0.05	0.06	(5)
8.	Miscellaneous (Interest on Federal Investments) ..	..	..	(6)
	Total Section A.	82.11	117.61	..
<i>B. Taxes which will be abolished on integration</i>				
9.	Salt . . . . .	..	..	(7)
10.	Customs Duties on <i>Internal</i> Trade . . . . .	..	..	(8)
	Total Section B. . . . .	..	..	..
	GRAND TOTAL	82.11	117.61	

COCHIN**Notes relating to Statement I****(1) Customs duties on Foreign Trade**

This represents Cochin's share of the customs revenue at Cochin Port "appropriate" to each year, according to the sharing arrangements with the Government of India. The figure for 1123 ME is *provisional* and must be confirmed after the final intimation is received from the Government of India.

(2) Corporation Tax

As "Corporation" Tax is not separately levied in Cochin, the total amount of Super Tax collections has been split up into "Corporation Tax" and "Ordinary Super Tax" approximately in the ratio of the Super Tax "demand" from Companies and that from other assesseees.

(3) Central Excise

The amount of Rs. 3.85 lakhs for 1122 ME is *provisional* and includes Rs. 1.80 lakhs, representing the entire collections in respect of tea and coffee for the year. Final accounts of the 'Pool' have not been received from the Government of India, but the State expects to retain the entire collection.

The collections on account of betel-nuts have been ignored as the duty has since been discontinued.

The figures under 'Central Excise' for 1947-48 have not yet been received from the Central Government; the figures for 1946-47 have been *provisionally* adopted for 1947-48 also.

(4) Railways

The Cochin State Railway is worked by the Government of India as part of the S.I. Railway system and the figure entered here against this item represents the State's share of the *net* earnings received from the Government of India. The figure for 1123 ME is *provisional* and must be revised when the actuals are known.

(5) Telephones

A small amount is paid as compensation by the Central Government based on the total rentals of telephones in the State.

(6) Interest on investments, which may ultimately be taken over by the Central Government *less* interest on liabilities, which may be similarly allocated to the Central Government, (other than interest on specific debt taken into account in Statement II) will have to be entered against this item.

(7) Salt

There was a collection of Rs. 4.90 lakhs under this heading in 1122 ME. This has to be ignored in view of the subsequent abolition of Salt Duty.

(8) Customs Duties on Internal Trade

Cochin does not levy any duties on Internal trade.

STATEMENT II—TRAVANCORE

Particulars of Expenditure, which will be saved to the State, as a result of Federal Financial Integration

Section and Serial No.	Particulars	Amount (Rs. in lakhs)		Ref. to Foot-notes
		1123 ME		
SECTION A				
<i>Expenditure to be taken over by the Government of India</i>				
1.	Cost of collection of taxes:			
	(1) Customs duties on foreign trade.		0.21	}
	(2) Central Excise duties			
	Tea & Coffee 1.27			
	Matches 0.14		1.41	(1)
	(3) Income-tax		1.67	
2.	National Highways		6.21	(2)
3.	Defence (ISF only)		45.37	(3)
4.	Aviation		0.35	
5.	Broadcasting		0.91	
6.	Meteorology		0.16	
7.	Archaeology		0.26	
8.	Geology (Survey) . . . . .		..
9.	Patents, Copyrights, Trade Marks, Joint Stock Companies		(—)0.19	(4)
10.	"Central" Civil Works, other than Military		0.20	(5)
11.	Pensions of Military and other "Central" personnel		2.23	(6)
12.	Accounts and Audit in respect of "Federal" transactions		0.35	(7)
	Total of Section A.		59.14	
SECTION B				
<i>Expenditure which will cease to be incurred on federal financial integration</i>				
13.	Internal Customs, including Tobacco Bankshalls		2.94	
	Total of Section B.		2.94	
	GRAND TOTAL		62.08	

TRAVANCORE

Notes relating to Statement II

(1) Cost of collection of duties: (Customs, Central Excise and Income-tax)

The figures have been computed on an estimated basis wherever there is a combined establishment for two or more taxes "Central" or "Provincial". In regard to Income-tax, 50 per cent. of the total cost of the department has been assumed to be "Central".

(2) National Highways

Based on a length of 207 miles of road-way stated to be eligible for declaration as "National Highways" the average annual maintenance being taken at Rs. 3,000 a mile [*vide* paragraph 17(1) of the Report].

(3) Defence

The cost of non-I.S.F. units has been excluded.

(4) Patents, Copyrights, Trade Marks, Joint Stock Companies

There is a small *net* receipt taking these heads together and this is shown in the Statement as a *minus* expenditure.

(5) "Central" Civil Works

The expenditure is very small and is estimated at Rs. 0.20 lakh.

(6) Pensions of Military and other "Central" personnel

The actual figures for Military personnel and an estimated amount for other "Central" personnel have been taken.

(7) Audit in respect of Federal transactions

As the State Government desire to continue their Audit and Accounts department under their control after financial integration, the only amount to be entered in the Statement is the cost of Audit of "Federal" transactions for which an estimated figure has been taken.

(8) General

In the event of the "Anchal" being abolished, the State Government will have to incur additional expenditure on "Service" postage.

As this additional expenditure would arise directly from federal financial integration, it has been agreed with the Travancore and Cochin Governments that the additional expenditure (assessed at twice the present expenditure on "Service" postage) should be allowed for as a deduction from expenditure taken over by the Centre.

STATEMENT II—COCHIN

Particulars of "Central" expenditure in Cochin State which will be taken over by the Central Government upon Federal Financial Integration

S. No.	Particulars	Actual Expenditure	Ref. to Foot- notes
		(Rs. in lakhs)	
		1123 M E	
		(47-48)	

SECTION A

Expenditure which will be taken over by the Government of India

1.	Cost of collection of taxes :		
	(1) Customs duties on Foreign Trade . . . . .	..	(1)
	(2) Central Excise duties	0.30	
	(3) Income-tax	1.12	(2)
2.	National Highways	2.25	(3)
3.	Defence	8 64	(4)
4.	Aviation, Broadcasting and Meteorology . . . . .	..
5.	Archaeology and Geology	0.18	
6.	Patents, Copyrights, Trade Marks and Joint Stock Companies	(-).0.17	(5)
7.	Federal Civil Works . . . . .	..
8.	Pensions of Military and "Federal" personnel (unless already included in preceding items)	0.50	(6)
9.	Accounts and Audit in respect of "Federal" transactions . . . . .	..	(7)
10.	Interest payments of a "Federal" nature	2.10	(8)
	TOTAL	14.92	

SECTION B

Expenditure which will cease to be incurred on federal financial integration

11.	Salt . . . . .	..
12.	Customs duties on Internal trade . . . . .	..
	TOTAL	..	
	GRAND TOTAL	14.92	

COCHIN

Notes relating to Statement II

(1) Cost of collection of Taxes (Customs duties on Foreign Trade)

There are no collection charges to be taken into account. The *net* receipts on account of Cochin Harbour Agreement are shown in Statement I.

(2) Cost of collection of taxes (Income-tax)

There is a combined establishment for Income-tax and Sales tax. The cost of collection of non-agricultural Income-tax has been taken as one half of the total expenditure.

(3) National Highways

Represents estimated expenditure on the maintenance at Rs. 3,000 a mile of 75 miles of roads which (according to information furnished by Ministry of Transport) are eligible for classification as "National Highways" at present.

(4) Defence

The expenditure on non-I.S.F. units has been excluded (on an estimated basis, under certain sub-heads, where actuals are not available).

(5) Patents, Copyrights, Trade Marks and Joint Stock Companies

The figures are *net* after deducting receipts in these Departments. The amount of receipts was greater than the expenditure; hence the *minus* figure.

(6) Pensions of Military and "Federal" personnel

No separate figures, are available for military pensions as the expenditure on Civil and Military Pensions is booked under one head. The figure of Rs. 0.50 lakhs is a rough estimate for "Federal" pensions.

(7) Accounts and Audit in respect of "Federal" transactions

The expenditure is negligible.

(8) Interest payment of a "Federal" nature

Represents annual interest at 3 per cent. on "specific debt" incurred in connection with Railways. As regards interest on other liabilities to be assumed by the Centre, please see note (6) in Statement I.

(9) General

In the event of the "Anchal" being abolished, the State Government will have to incur additional expenditure on "Service" postage. As this additional expenditure would arise directly from federal financial integration, it has been agreed with the Travancore and Cochin Governments that the additional expenditure (assessed at twice the present expenditure on "Service" postage) should be allowed for as a deduction from expenditure 'taken over' by the Centre.

STATEMENT III—TRAVANCORE
Analysis of Liabilities as at end of 1123 M E.

S. No.	Particulars	“Central”	“Others” (Rs. in lakhs)	Total	Ref. to Foot- notes
(A) BANKING OR CURRENT LIABILITIES					
1.	Remittance and Ways and Means Advances (Treasury bills etc.)		81.55	81.55	
2.	Sinking Fund		17.20	17.20	
3.	Savings Bank Deposits		760.57	760.57	(1)
4.	Life Insurance Fund		56.02	56.02	
5.	Accident Insurance Fund		5.51	5.51	
6.	Teachers' Provident Fund		10.59	10.59	
7.	State Provident Fund		50.00	50.00	
8—9.	Defence Provident Fund and Work Establishment Provident Fund		0.14	0.14	(2)
10.	Departmental and other deposits		211.23	211.23	
11.	Transport Insurance Fund		0.14	0.14	
12.	Kandukrishy Fund		4.98	4.98	
13.	Devaswom Fund		8.28	8.28	
14.	Post-war Services Fund	33.61	..	33.61	
TOTAL OF SECTION (A)		33.61	1206.21	1239.82	
(B) SPECIFIC “FUNCTIONAL” FUNDS					
1.	Village Uplift Fund		114.01	114.01	
2.	Irrigation		0.97	0.97	
3.	Road Development		(-)3.38	(-)3.38	
4.	Distress Relief		8.55	8.55	
TOTAL OF SECTION (B)			120.15	120.15	
(C) SPECIFIC ASSET DEPRECIATION AND RESERVE FUNDS					
1.	Depreciation and Reserve Funds . . . . .		..	..
2.	Asset Reserve Funds :				
	(a) Land Mortgage Bank		1.59	1.59	
	(b) Transport		20.97	20.97	
3.	Post-war Reconstruction Fund		524.07	524.07	
TOTAL OF SECTION (C)			546.63	546.63	

Sl. No.	Particulars	"Central" (Rs in lakhs)	Others	Total	Ref. to Foot- notes
(D) OPEN OR GENERAL RESERVES					
1.	Revenue Reserve Fund . . . .	..	..	..
2.	General Reserve Fund . . . .	..	75.30	75.30	
TOTAL OF SECTION (D)		..	75.30	75.30	
(E) PUBLIC DEBT					
1.	"Specific Debt" (Railways)	114.40	..	114.40	
2.	Public Debt (other than "Specific Debt") Rs. 365.45 lakhs				
	<i>Less</i> Sinking Fund Rs. 17.20 lakhs		348.25	348.25	
TOTAL OF SECTION (E)		114.40	348.25	462.65	
GRAND TOTAL—SECTIONS (A) TO (E)		148.01	2296.54	2444.55	

Notes relating to Statement III.—

- (1) This liability will have to be treated as "Central" if it is decided to abolish the Anchal Department as a result of federal financial integration.
- (2) So much of the Provident Fund balances as relates to personnel transferred to the Central Government will have to be taken over by that Government.

STATEMENT III—COCHIN
Analysis of liabilities as at the end of 1123 M.E.

S. No.	Particulars	“Central”	“Others” (Rs. in lakhs)	Total
(A) BANKING OR CURRENT LIABILITIES				
1.	Ways and Means Advances (Overdraft)	139·20		139·20
2.	Sinking Funds	36·42		36·42
3.	Savings Bank Deposits	14·59		14·59
4.	Life Insurance Fund	0·03		0·03
5.	Motor Accident Insurance Fund	0·21		0·21
6.	State Provident Fund including Cochin Aided School Teachers P. F. and Palace Provident Fund.	30·17		30·17
7.	Departmental and Other Deposits	56·72		56·72
8.	Temple Funds	5·70		5·70
9.	Palace Funds	3·40		3·40
10.	Municipal Funds	6·11		6·11
11.	Negative balance on Remittance Account	40·82		40·82
TOTAL—“Banking ” or “Current” Liabilities . (A)		333·37		333·37
(B) SPECIFIC “FUNCTIONAL” FUNDS. PROVINCIAL				
1.	Village Uplift Fund (Rural Development funds, Panchayats, Libraries, Co-operative, Ayurveda, Public Health, Uplift of D. C., Industries)	3·14		3·14
2.	Agricultural Improvement	0·10		0·10
3.	Road Canal Development	9·26		9·26
4.	Distress Relief (Cyclone Damage Relief Fund)	0·42		0·42
TOTAL “Functional” Funds—“Pro- vincial” (B)		12·92		12·92
(C) SPECIFIC ASSET, DEPRECIATION FUNDS AND RESERVE FUNDS (“PROVINCIAL”)				
1.	Depreciation Funds . . . . .	..		..
2.	Asset Reserve Funds	2·00		2·00
	Post-War Reconstruction Fund	7·91		7·91
TOTAL—(C)		9·91		9·91

S. No.	Particulars	"Central"	Others (Rs. in lakhs)	Total
(D) OPEN OR GENERAL RESERVES				
	Revenue Reserve Fund		36.50	36.50
	Industrial Development Fund . . .		26.25	26.25
	TOTAL—(D) .		61.75	61.75
(E) PUBLIC DEBT (PERMANENT DEBT)				
		(Rs. in lakhs)		
	Public Loan (1955-58)		100.00	
	<i>Deduct</i> amount transferred to the assets statement side as Specific Debt on Hydro Electric Schemes		30.00	
	<i>Deduct</i> Sinking Fund		36.42	
	GRAND TOTAL		451.53	451.53

STATEMENT IV—TRAVANCORE

Analysis of Current or Liquid Assets as at the end of 1123 M.E.

S. No.	Particulars	Amount (Rs. in lakhs)	Remarks
(A) CASH AND BULLION			
1.	Bullion Account	2.65	
(B) BANK DEPOSITS			
2.	Short-term Deposits in Banks.	66.16	
3.	Deposits (not bearing interest) in the Imperial Bank of India	2.54	
		68.70	
(C) SHARES AND INVESTMENTS			
4.	Surplus Investments in gilt-edged securities	479.84	
5.	General Reserve Fund Investment	74.37	
6.	Sinking Fund Investment	0.65	
7—8.	Shares in Industrial Development concerns and Shares in Banks and other concerns	373.88	
9.	Shares in the Travancore Credit Bank	21.16	
10.	Deposits in the Life Insurance Fund Investment Account	53.13	
11.	Defence Savings Provident Fund Investments	0.06	
12.	Distress Relief Fund Investment	8.52	
13.	P. W. Services Reconstruction Fund Investment Account	33.61	
14.	Accident Insurance Fund Investment Account	0.67	
		1045.89	
(D) LOANS AND ADVANCES			
15.	Advances repayable	224.30	
16.	Loans made by Government	156.93	
17.	Loans to Cochin Port Conservancy Board	36.95	
		418.18	
(E) MISCELLANEOUS			
18.	Coinage Account	0.75	
19.	Suspense	127.85	
20.	Remittance	16.92	
		145.52	
GRAND TOTAL A—E		1680.94	

STATEMENT IV—COCHIN

Analysis of Current or Liquid Assets as at the end of 1123 M.E.

S. No.	Particulars	Amount (Rs. in lakhs)
(A) CURRENT ASSETS		
1.	Cash Balance, Bank Balance, etc.	39·52
2.	Surplus Investments in gilt-edged securities	64·64
3.	Shares in Industrial Development Concerns	5·15
4.	Shares in Banks and Other Concerns	0·64
5.	Deposits in Banks	37·50
6.	Investments relating to Sinking Funds	35·58
7.	Current Loans and Advances (Agricultural advances, Loans to Companies and Miscellaneous Advances)	23·26
8.	Loans to Cochin Harbour	73·97
	<i>Less</i> Specific Debt incurred in connection with grant of loans to the Cochin Harbour—	
	Public Loan	30·00
	Loans from the Govt. of India	20·21
		50·21
		23·76
9.	Food-grains Capital Account	232·39
	<i>Less</i> Estimated amount of Losses to be written off	120·00
		112·39
10.	Positive Balance on Remittance Account	39·48
	TOTAL "Current" Assets (A).	381·92