CABINET.

INDIAN ROUND TABLE CONFERENCE.

Note by the Secretary of State for India.

I circulate for the information of my colleagues the Third Report of the Federal Structure Committee of the Conference.

(Intld.) S. H.

India Office, S.W.I.

November 19th, 1931.
It is requested that the undermentioned footnote may be inserted at the bottom of page 7 of the copy of the above document, which was circulated on November 16th. This amendment will, of course, be incorporated in the Report as finally printed.

Footnote to paragraph 14.

The Muslim delegation and some others are unable to subscribe to the whole of this paragraph, as they are opposed to the principle of giving weightage to the representation, in the Legislature, of the States in excess of their population proportion.

(rgd). R.H.A. CAREER.
Indian Round Table Conference
(SECOND SESSION)

Third Report
of the
Federal Structure Committee

St. James's Palace, S.W.1.
November, 1931.
FEDERAL STRUCTURE COMMITTEE.
(Second Session.)

COMPOSITION:

Lord Sankey (Chairman).
*Mr. Wedgwood Benn.
*Major W. E. Elliot.
*Viscount Hailsham.
Sir Samuel Hoare.
Mr. H. B. Lees-Smith.
The Marquess of Lothian.
The Earl Peel.
*Mr. F. W. Pethick-Lawrence.
The Marquess of Reading.
*H.H. The Maharaja Gaekwar of Baroda.
H.H. The Nawab of Bhopal.
H.H. The Maharaja of Bikaner.
*H.H. The Maharaj Rana of Dholpur.
*H.H. The Maharaja of Rewa.
Sir Akbar Hydari.
Sir Mirza Ismail.
Colonel K. N. Haksar.
*Dr. B. R. Ambedkar.
*Sir Maneckjee B. Dadabhoy.
*Mr. M. K. Gandhi.
*Mr. A. R. Iyengar.
Mr. M. R. Javarkar.
Mr. M. A. Jinnah.
Mr. T. F. Gavin Jones.
*Mr. N. M. Joshi.
*Pandit Madan Mohan Malaviya.
*Sir Provash Chunder Mitter.
Diwan Bahadur Ramaswami Mudaliyar.
Sir Sayed Sultan Ahmed.
Sir Tej Bahadur Sapru.
Mr. Srinivasa Sastri.
*Dr. Shafa’at Ahmad Khan.
Sir Muhammad Shafi.
*Mrs. Subbarayan.
*Mr. Price of Thakur Das.
Sardar Ujjal Singh.
*Mr. Zafrullah Khan.
* Denotes new members.

Sir Manubhai Mehta acted as substitute in the absence of H.H. The Maharaja of Bikaner.

Lord Snell acted as substitute in the absence of Mr. Wedgwood Benn, Mr. Lees-Smith and Mr. Pethick-Lawrence.

Rao Bahadur Krishna Chari acted as substitute in the absence of H.H. The Maharaja Gaekwar of Baroda.

Mr. E. C. Benthall acted as substitute in the absence of Mr. Gavin Jones.

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INTRODUCTORY.

1. The Committee's task at the Second Session of the Conference was to continue their discussions at the point at which they were left by their Report of the 13th January, 1931, and by the Prime Minister's Declaration of the 19th January, and to endeavour, so far as possible, to fill in the outlines of the Federal Constitution for Greater India which was sketched in those documents.

2. In approaching this task, the Committee have been assisted by colleagues who did not share in their earlier deliberations. In this connexion it will be remembered that, in virtue of an agreement recorded in March last, the Indian National Congress decided to participate in their labours.

3. Since January last, there has been much public discussion of the constitutional proposals which emerged from the last Session of the Conference. The Committee resumed their deliberations with the knowledge of this public discussion, and with the conviction that it is in a Federation of Provinces and States that the solution of the problem of India's constitutional future is to be found.

4. A further examination of the problem has confirmed them in the belief that by no other line of development can the ideal in view be fully realised. For this purpose it is essential that the "India" of the future should include, along with British India, that "Indian India" which, if Burma is excluded, embraces nearly half of the area and nearly one-fourth of the population of the country—an area and population, moreover, which are not self-contained and apart geographically or racially, but are part and parcel of the country's fabric; and its constitution must be drawn on lines which will provide a satisfactory solution for the problem of the existence, side by side, of future self-governing Provinces and of States with widely varying polities and different degrees of internal sovereignty, whose fortunes are, and must continue to be, closely interwoven.

5. The Committee rejoice to think that the Princes, while naturally determined to maintain their internal sovereignty, are prepared, and indeed anxious, to share with the British Indian Provinces in directing the common affairs of India.

6. It will be easy for the constitutional purist, citing federal systems in widely different countries, to point out alleged anomalies in the plans which the Committee have to propose to this great end; but the Committee, as they stated in their First Report, are not dismayed by this reflection. Their proposals are the outcome of an anxious attempt to understand, to give full weight to, and to reconcile, different interests.
7. The Committee have taken into account:—

(a) The widespread desire in India for constitutional advance;
(b) the natural desire of the Indian States to conserve their integrity;
(c) the indisputable claims of minorities to fair treatment;
(d) the obligations and responsibilities of His Majesty's Government; and
(e) the necessity, paramount at all times, but above all at a transitional period like the present, when the economic foundations of the modern world seem weakened, of ensuring the financial credit and the stability of Government itself.

8. Without a spirit of compromise, such diverging interests cannot be reconciled; but compromise inevitably produces solutions which to some, if not to all, of the parties, may involve the sacrifice of principle.

9. It follows that, in many cases, many members of the Committee would have preferred some solution other than that which appears as their joint recommendation. But recognising that the basic aim of this Conference is, by the pooling of ideas and by the willingness to forego for the common good individual desires, to attain the greatest measure of agreement; above all, recognising that the time has come for definite conclusions, the Committee are prepared to endorse the conclusions set out in this Report.

THE STRUCTURE, SIZE, AND COMPOSITION OF THE FEDERAL LEGISLATURE.

10. The Committee expressed the view in their previous Reports that the legislative organ of the Indian Federation should consist of two Chambers, which will be empowered to deal with the whole range of the activities of the Federation, both those which affect British India only, and those which affect all federal territory. In the course of their discussions, preferences were expressed in some quarters for a unicameral Legislature, on considerations alike of simplicity, efficiency and economy; while some members urged that, having regard to the nature of the matters to be dealt with by the Federation, a single small Federal Chamber, which would adequately reflect the views of the governments of the constituent Units, would be the right solution of the problem.

11. At a later stage, again, the Committee were placed in possession of proposals which they have not been able fully to discuss, but which clearly demand further consideration, though the Committee fully realise that the adoption of either of these plans would involve material modification of the framework hitherto contemplated.
12. One of these plans would substitute for the Upper Chamber a small body consisting of nominated delegates of the governments of the federating Units, which would have the right of initiating legislation and would be empowered to exercise a suspensory veto over the measures passed by the elected Chamber. This body would also have the right to express its opinion upon all measures of the Federal Government before they were laid before the elected Chamber. The authors of this plan also contemplate the possession by this body of certain advisory functions in the administrative sphere.

13. The second of these plans contemplates the confederation of the States into a single collective body for the purpose of federating with the British Indian Provinces. Its supporters would prefer a single Federal Chamber in which the representation of the Indian States collectively should be 50 per cent., the representatives being selected by an electoral college consisting of the federated States as a whole. In the event of a decision in favour of a bicameral Legislature, 50 per cent. of the seats in the Upper Chamber would be reserved for the States, their representation in the Lower Chamber being on population basis.

14. Upon the assumption, however, that the Legislature is to be bicameral, a variety of factors must be taken into account in determining the size of the Chambers. Cogent theoretical arguments can be adduced (and were in fact advanced by some Delegates) in support of the view that, for a country of the size and population of India, a Legislature consisting of from 600 to 700 members for the Lower Chamber, and from 400 to 500 for the Upper, could not be regarded as excessive in size, and that smaller numbers would fail to give adequate representation to the many interests which might reasonably claim a place in it. On the other hand, arguments no less forcible were adduced in favour of the view that Chambers exceeding 100 and 250 respectively might prove ineffective organs of business. We have given these divergent views the best consideration of which we are capable, and recommend as the result that the Chambers should consist, as near as may be, of 200 and 300 members respectively, in which the allotment of seats to the States should be in the proportion of 40 per cent. (or approximately 80 seats) in the Upper Chamber, and 33 1/3 per cent. (or approximately 100 seats) in the Lower.

15. This latter recommendation is, of course, based on the assumption that the whole body of the States will eventually adhere to the Federation. The view was strongly expressed that, in the case of States not adhering at the outset, seats allotted to them as the result of the procedure contemplated in paragraph 26 should remain unfilled pending their adherence. But it was also urged that this might lead to a situation under which States adhering at the outset
would find their total voting strength in the Legislature so small as to be inconsistent with their position as representing one of the main constituent elements in the Federation. Some members of the Committee have stated it as their opinion that, in the event of the original adherents not forming a substantial proportion of "Indian India," some method should be devised by which their voting strength would be temporarily augmented pending the accession of other States. But the whole Committee hope that the contingency which might necessitate such an augmentation will not arise.

16. In any event, difficulty might arise in regard to States which are grouped for the purpose of deputing a representative: but it would be premature to attempt to suggest the best solution for such problems until the measure of adherence by "grouped" States can be fairly accurately ascertained or foreseen. The Committee accordingly content themselves with expressing the hope that the measure of adherence in each group will be sufficiently great to justify the filling of the seat allotted thereto by the nominations of the adhering States. Should the system of grouping be such as to admit of the allotment of two or more seats to one group, difficulties of this order would be more easy of solution.

17. The Committee recommend that the 200 members of the Upper House should be chosen in the main to represent the component Units—the Provinces of British India and the States—and that the representatives of the British Indian Provinces should be elected by the Provincial Legislatures by the single transferable vote. Candidature for the Federal Legislature should not, of course, be restricted to members of a Provincial Legislature, though such persons should be eligible if otherwise qualified. But no person should be a member of both a Provincial and the Federal Legislature.

18. In the case of those States which secure individual representation, their representatives will be nominated by the Governments of the States. In the case of those States, however, (and there will necessarily be many such) to which separate individual representation cannot be accorded, the privilege of nomination will have to be shared in some manner which it will be easier to determine when the various groups have been constituted—a process which will, of course, entail a detailed survey of local and regional circumstances.

19. For the Lower Chamber, the Committee consider that the selection of the British Indian representatives should be by election otherwise than through the agency either of the Provincial Legislature or of any existing local self-government bodies.* Most members

* This expression is not intended to exclude such bodies as Village Boards or Village Panchayats.
consider that election should be by territorial constituencies, consisting of qualified voters who will cast their votes directly for the candidate of their choice. Others have advocated some method whereby some of the obvious difficulties which must confront a candidate, in canvassing and maintaining contact with so large an area as the average constituency will involve, may be obviated.

20. The actual framing of the constituencies must necessarily depend largely upon the detailed arrangements to be made for the revision of the existing franchise—a task which is to be undertaken by a special Franchise Committee. The Committee therefore recommend that this body should be charged also with the duty of making proposals for the constituencies to return the British Indian members of the Lower Chamber of the Federal Legislature, and that it should explore fully the alternatives of direct and indirect election, indicated in the preceding paragraph, in the light of the practical conditions which will be presented by the size of constituencies, their populations and the proportion of this population to be enfranchised. The area and population of British India, excluding Burma, being, in round figures, 800,000 square miles and 235 millions respectively, and the seats in the Lower Chamber available for representatives of that area, on the Committee's proposals, being approximately 200, it follows that the average area of a constituency would be approximately 4,000 square miles, and the average population per seat some 1½ millions. And while, in many cases, the former of these figures would obviously be reduced by the natural grouping of the population in urban areas, the difficulties presented by electoral areas and populations of this size would, of course, be accentuated by the existence of separate communal electorates. It may well be that, while no difficulty will be experienced in providing for direct election in urban areas, some method of indirect election may prove desirable for rural areas.

21. As regards the apportionment of the British Indian seats in both Chambers to the Provinces inter se, the Committee recognise that the population ratio, which they were disposed to recommend in their previous Report as the guiding principle, would not produce a satisfactory result unless it were tempered by other considerations. To take only one instance, it would immediately reduce the Bombay Presidency—a Province of great historical and commercial importance, which has for many years enjoyed approximately equal representation in the Central Legislature with the other two Presidencies and the United Provinces—to less than half the representation these latter will secure.

22. For the Upper Chamber, which will represent in the main the Units as such, the Committee think that the guiding principle should be a reasonable approximation to equality of representation for each Unit. Absolute equality, having regard to the great variations in size and population between the Provinces, would obviously be inequitable. The problem is a difficult and complicated one, involving the careful
assessment of local factors, which is beyond the competence of this Committee. But the suggestion has been made that a possible solution might, for example, be to assign to each of the Provinces which exceed 20 millions in population—namely, Bengal, Madras, Bombay, the United Provinces, the Punjab and Bihar and Orissa—an equal number of seats, say, 17; to the Central Provinces (if it included Berar) and Assam, say, 7 and 5 seats respectively; to the North-West Frontier Province, 2 seats; and to Delhi, Ajmer, Coorg and British Baluchistan, 1 seat each.

23. In the Lower Chamber, representing as it will primarily the population of the federated area, we consider that the distribution should tally as closely as possible with the population ratio, but that some adjustment will be required in recognition of the commercial importance of the Bombay Presidency and of the general importance in the body politic of the Punjab, which it will be generally conceded is not strictly commensurate with its population as compared with that of other Provinces. We suggest that this adjustment might be secured in the case of Bombay, to some extent at all events, by adequate weightage of the special representation which we have recommended for Indian and European Commerce and, in the case of the Punjab, by some arbitrary addition to the 18 seats which it would secure on the basis of its population. Here again, the Committee are not in a position to make a definite recommendation, but they take note of a suggestion which has been made for the allotment to the Punjab and Bombay, and also to Bihar and Orissa, of 26 seats each; to Madras, Bengal and the United Provinces, of 32 seats each; to the Central Provinces, of 12; to Assam, of 7; to the North-West Frontier Province, of 3; and to the four minor Provinces, of 1 each—by this measure securing a distribution of the 200 seats which might be held to satisfy reasonable claims without doing undue violence to the population basis. But these figures, and those suggested in paragraph 22, would obviously require further consideration.

APPORTIONMENT BETWEEN THE STATES OF THEIR QUOTA.

24. The Committee recognise that this is primarily a matter for settlement among the Princes themselves; but the representatives of other interests can hardly regard it as a matter of indifference since, until a satisfactory solution is found, the idea of federation necessarily remains inchoate, and an important factor in determining the decision of individual States as to adherence to the Federation will be lacking. In view of the admitted difficulties of the question, the Committee are anxious to assist by friendly suggestions towards the consummation of an acceptable and generally accepted conclusion. The Committee are fully aware that the effective establishment of federation postulates the adherence of the major States and that the absence of even a few
of the most important States, however many of the smallest might be included, would place the Federation under grave disadvantages. At the same time, they think that it is essential that the States as a whole should secure representation which will commend itself to public opinion as generally reasonable, and that it is hardly less important to satisfy, so far as may prove possible, the claims of the small States, than to provide adequate representation for those which cover large areas.

25. Two suggestions have been advanced, in the course of the Committee's discussions, for the solution of this problem. The first was that the matter should be entrusted to the Chamber of Princes, with such arrangements as would secure an adequate voice in its deliberations to the small States, and to such States as are not represented in the Chamber at all. The second, based on the belief that the inherent difficulties of the problem would prove such that the Princes—acting through whatever agency—would be unable to evolve a plan which would meet with general acceptance and satisfy all claims, and consequently that a procedure based upon the first suggestion would merely involve infructuous delay, was that the task of apportionment should be remitted to an impartial Committee or tribunal on which the States themselves should not be given any representation, but before which they would all be invited to urge their claims.

26. The Committee are not in a position, for reasons already stated, to make any definite recommendation as to the acceptance of either of these suggestions; but they consider that the best course would be to allow a period of time, which should not, they think, extend beyond the end of March, 1932, within which the Princes should be invited to arrive at a settlement, on the understanding that, if within that period a settlement were not in fact secured, an impartial tribunal would be set up by His Majesty's Government to advise as to the determination of the matter.

METHOD OF SELECTION OF STATES' REPRESENTATIVES IN THE LOWER CHAMBER.

27. While the Committee remain of opinion that this question must be left to the decision of the States, it cannot be contended that it is one of no concern to the Federation as a whole. They note the assurances of certain individual members of the States Delegation that, in those States which possess representative institutions and for which these members were in a position to speak, arrangements will be made which will give these bodies a voice in the Ruler's selection. The Committee as a whole are prepared to leave this matter to the judgment of the States.
REPRESENTATION OF SPECIAL INTERESTS IN THE FEDERAL LEGISLATURE.

28. In paragraph 34 of their Second Report, the Committee recommended that special provision should be made in the Federal Legislature for the representation of the Depressed Classes, Indian Christians, Europeans, Anglo-Indians, Landlords, Commerce and Labour. We make no recommendation here relating to the first four of these interests, regarding the extent and method of their representation, nor for the representation of Women in the Legislature, since the decisions on these points are for the Minorities Committee.

29. But we affirm our previous recommendation that provision should be made for the special representation of the Landlord interest, of Commerce (European and Indian) and of Labour. The number of seats to be assigned to each of these four interests and their apportionment amongst the various Provinces are questions which should be considered by the Franchise Committee, as also is the question of their method of election. Wherever possible, the method should be election rather than nomination.

NOMINATED MEMBERS.

30. In paragraph 34 of the Committee's Second Report, the suggestion was also made that the Governor-General should be empowered to nominate to each Chamber a specified number of persons, not exceeding perhaps ten, to represent the Crown. After further consideration, the Committee see no advantage to be gained from pursuing this suggestion. The persons appointed by the Governor-General to assist him in the administration of the Reserved portfolios will, of course, play their part in the business of the Legislature; but it is not apparent how their task would be facilitated by the presence of a small body of nominated members who, if they were non-officials would rarely possess any special or effective knowledge of questions connected with the administration of the reserved Departments, and whose votes would be too few to influence decisions.

31. If, on the other hand, these members were officials chosen for their knowledge of the subjects in the Governor-General's charge, the same difficulty would be experienced as under the present régime of sparing from their departmental duties, for attendance in the Legislature, so considerable a number of officials as the suggestion contemplates. Moreover, the voting power which such officials would exercise would either be negligible or else would tend to maintain an "official bloc" which, in the opinion of the majority of the Committee, would be out of place in the conditions of the new constitution.

32. On the other hand, while the Committee, for the reasons given, are not prepared to advocate the nomination of members in either Chamber to represent the Crown or Crown interests, they are impressed with the desirability of securing to the Federation the services in the Upper Chamber of persons of the elder statesman
type with an experience of public affairs, both in the political sphere and outside it. It may well be that persons of this type, whom India would delight to honour, may be unwilling, through the absence of provincial influence or connexions, to solicit the suffrages of Provincial Legislatures, or to promote their candidatures by identifying themselves with particular political parties; and the small chances of success at the polls, when party feeling runs high, likely to be attained by persons possessing, in the English phrase, the "cross-bench" mind, need not be emphasised. Yet it would be a grave loss to India if such persons were excluded from her counsels. The Committee are, therefore, of opinion that a small proportion of seats should be reserved, in the Upper Chamber only, for persons to be appointed by the Governor-General. The Governor-General would, in making these appointments, act as a general rule upon the advice of his Ministers, though we are disposed to think that, possibly by a constitutional convention, possibly by provision in the Constitution Act, two or three of the appointments might be made on the Governor-General's personal responsibility. In order to avoid any suggestion, however, of an official bloc, the Committee are of opinion that no serving official should be qualified to sit in the Upper Chamber as a nominated member.

QUALIFICATIONS AND DISQUALIFICATIONS FOR MEMBERSHIP.

33. For the Lower Chamber, in British India the qualification for membership should be identical with that for a voter; that is to say, any person who is qualified as an elector for a constituency of a particular class should be qualified also to stand for election by any constituency of that class in the Province.

34. But, for candidates for the Senate, certain additional qualifications should be laid down. Without attempting to prescribe these in detail—a task which would better be undertaken by the Franchise Committee—we consider that the existing rules regulating the qualifications of voters (and consequently of candidates) for the Council of State should be adopted as a model for candidates for the Upper Chamber, except that the minimum age limit should be 35 years, and subject to such modifications as may be necessary to prevent the virtual exclusion of women, the Depressed Classes and Labour.

35. It will be necessary also to prescribe the qualifications of voters in the special constituencies we have recommended to secure the representation in the Upper Chamber of Landlords, Commerce (European and Indian) and Labour; and—subject to the age limit just suggested—a person qualified as a voter in any of the special constituencies should be qualified also as a candidate. Whether, in the case of all or any of these special constituencies, the present qualifications for voters for the Council of State could be adopted as they stand, appears doubtful; but this we would leave for the consideration of the Franchise Committee.
36. The existing disqualifications for membership for the Indian Legislature appear to us generally suitable for retention, though there was some difference of opinion as to those arising out of convictions for criminal offences, and suggestions were made—which we regard as impracticable—that a distinction should be drawn for this purpose between "political" and other offences, or between offences involving moral turpitude and those which do not. On the whole, we regard a restriction of this nature on the free choice of the elector as of little value as a means of ensuring probity of character in candidates, and we recommend that they should be abandoned. At the same time, some members of the Committee consider that the rules should be so framed as to disqualify from candidature any person, who at the time of an election, is actually undergoing a sentence of imprisonment and who would consequently be unable, if returned, to fulfil his duties to the Legislature and to his constituents. On the other hand, a section of the Committee is opposed to this view, being of opinion that a sentence of imprisonment should not, in any circumstances, constitute a disqualification.

37. Although it will clearly be impossible to secure uniformity of qualification in British India and the States, we think it of great importance that there should be absolute uniformity in the matter of disqualifications. These should, therefore, be embodied in the constitution and should apply to all candidates alike.

OATH OF ALLEGIANCE.

38. The Committee consider that, following common practice in the Empire, the Indian Constitution should provide for an Oath of Allegiance to be taken by members of the Federal Legislature on assumption of their seats. They do not suggest a definite formula at this stage, but its terms will require careful consideration.

RELATIONS BETWEEN THE TWO CHAMBERS.

39. As will appear from paragraphs 25 and 35 of the Committee's Second Report, this important question was discussed for the first time in the Committee's present Session. The careful consideration we have now given to the matter has led us to the view that nothing should be done in the new constitution which would have the effect of placing either Chamber of the Federal Legislature in a position of legal subordination to the other. It would be a misconception of the aims which we have in view to regard either Chamber as a drag or impediment on the activities of the other. In our view, the two Chambers will be complementary to each other, each representing somewhat different, but, we hope, not antagonistic, aspects of the Federation as a whole. Absolute equality between the two Chambers of a bicameral Legislature is no doubt unattainable, and, if it were attainable, might well result in perpetual deadlock; and there is no less doubt that, the
provisions of the constitution notwithstanding, the evolution of political development will inevitably result, in the course of time, in placing the centre of gravity in one Chamber.

40. But, so far as the letter of the constitution is concerned, we consider that, subject to the consideration shortly to be mentioned, there would be no justification for endowing one Chamber at the outset with legislative powers which are denied to the other. We accordingly recommend that, while the constitution should provide that, subject to the special provisions to be referred to later, no Bill should become law until it is assented to by both Chambers, it should contain no provisions which would disable either Chamber from initiating, amending or rejecting any Bill, whatever its character. This principle should, however, in the opinion of almost all the British Indian Delegates, be subject to the exception that the right of initiating Money Bills should vest in the Lower Chamber alone, though the States Delegation were almost unanimously opposed to the drawing of this distinction. Subject, of course, to the decision on the point just mentioned, the principle of equality also appears to us to demand that the Government should be entitled to test the opinion of the other Chamber if one Chamber has seen fit to reject a Government Bill, and that, in the event of its passage by the Second Chamber it should be treated as a Bill initiated in that Chamber and taken again to the first.

41. In the event of rejection by one Chamber of a Bill which has been passed by the other, or of its acceptance by either in a form to which the other will not agree, we recommend that, subject to certain conditions which should be set out in the constitution, the Governor-General should have power, either after the lapse of a specified period or, in cases of urgency, at once, to secure the adjustment of the difference of opinion by summoning a Joint Session.

42. As regards the voting of Supply, the opinion of British Indian Delegates was almost unanimously in favour of confining this function to the Lower Chamber. Their view was based on the precedent afforded in this respect, not merely by almost every other constitution, but by the actual powers which have been enjoyed by the Indian Legislative Assembly during the past ten years. The States Delegates, however, were almost unanimously of opinion that the principle of equality of powers should apply also to the voting of Supply. In their view, since the Supply required by the Federal Government will be required for the common purposes of the Federation (or for the common purposes of British India), there is no logical reason which could be adduced in favour of depriving the representatives of the Federal Units in the Senate of a voice in the appropriation of the revenues, the responsibility of raising which they would share equally with the members of the other Chamber.
43. Whatever may be the decision between these conflicting views, the Committee assume that the Demands for Grants, whether voted upon by both Chambers or only by the Lower Chamber, would be so arranged as to separate expenditure required for Federal purposes from that required for "Central" purposes, so that the latter might stand referred to a Standing Committee of the British Indian members of both Chambers.

FEDERAL FINANCE.

44. The Committee did not find time during the first Session of the Conference to consider the subject of "Federal Finance," which may be summarily described as the question of the apportionment of financial resources and obligations between the Federation and the Units. On taking up this subject, the Committee found it desirable to remit it for examination by a sub-Committee, over which Lord Peel presided.

45. The Report of this sub-Committee, which was in effect unanimous, is appended to this Report. Little criticism was directed to its main features, and the Committee accept the principles contained in it as a suitable basis on which to draft this part of the constitution.

46. The Committee were, however, not satisfied with the proposals in Lord Peel's Report for a review of the problem by Expert Committees. Fear was widely expressed that these might, by recommending principles at variance with those upon which the Conference was agreed, tend to undo work already accomplished; and further, that the procedure suggested might cause unnecessary, and perhaps dangerous, delay in settling various points which had an important bearing on the character of the new Federation. The Committee accordingly consider that the suggested procedure should be revised in the manner described below.

47. No change need be made as regards the second of the two Committees (concerned with paragraphs 17-20 of Lord Peel's Report), except that it should have no connection with the other Committee. It should be noted that, of the matters within the purview of this "States" Committee, it is only in respect of those dealt with in paragraph 18 of Lord Peel's Report that it is essential to reach a settlement before the Act setting up the Federation comes into operation.

48. In place of the first Committee recommended in Lord Peel's Report, there should, as early as possible, be appointed in India a "fact-finding" Committee, consisting of officials familiar with
questions of finance, including States’ finance. Without elaborating terms of reference, the functions of this Committee may be sketched as follows:

(a) To investigate the division of pension charges (paragraph 5 of Lord Peel’s Report).

(b) To investigate the classification of pre-Federation debt, as contemplated at the end of paragraph 6 of Lord Peel’s Report.

(c) To calculate the effect on the Provinces of various possible methods (of which there are only a few to be considered) of allocating the proceeds of Income-tax to the Provinces.

(d) To give an estimate of the probable financial position of the Federation in its early years under the scheme proposed in Lord Peel’s Report, indicating, inter alia, the probable results of federalising Corporation tax, Commercial Stamps, Tobacco excise, or other possible national Excises.

Of these, (d) is the most important.

It was pointed out that (b) had no reference to the investigation of any claim such as had been raised by the Congress, that liability for a portion of the Public Debt of India ought to be undertaken by the United Kingdom.

49. The facts and estimates required from the Committee described in the preceding paragraph should not take long to produce. There will remain to be decided, in the light of them, certain questions, as, for example—

(i) The exact detailed form of the list of Federal taxes (within the general framework laid down by Lord Peel’s Report); in particular, a final decision will have to be taken about Corporation tax and specific Federal Excises.

(ii) The initial amount of the Contributions from the Provinces.

(iii) The precise period to be laid down for the extinction of the Provincial Contributions referred to in (ii), and of the contributions from certain States which are to be reviewed under the procedure mentioned in paragraph 47 above.

(iv) The exact method according to which Income-tax is to be returned to the Provinces.

50. There will also be one or two other points, left doubtful by Lord Peel’s sub-Committee, which will fall for decision. It will be necessary to devise a procedure for discussion and settlement of the outstanding matters.

51. It may be that, in other fields, points of substance directly affecting federation will also remain for settlement after this Session of the Conference. It might thus prove convenient to use a common machinery for their disposal. It is accordingly agreed that this question of procedure should be postponed to a later stage.
52. The necessity for the establishment of a Federal Court was common ground among all members of the Committee, and such differences of opinion as manifested themselves were concerned, for the most part, with matters of detail rather than of principle. It was recognised by all that a Federal Court was required both to interpret the constitution and to safeguard it, to prevent encroachment by one federal organ upon the sphere of another, and to guarantee the integrity of the compact between the various federating Units out of which the Federation itself has sprung.

53. The first question which the Committee considered was the nature of the Court's jurisdiction, and it was generally agreed that this jurisdiction must be both original and appellate.

54. The Court ought, in the opinion of the Committee, to have an exclusive original jurisdiction in the case of disputes arising between the Federation and a State or a Province, or between two States, two Provinces, or a State and a Province. The Committee are of opinion that disputes between Units of the Federation could not appropriately be brought before the High Court of any one of them, and that a jurisdiction of this kind ought rather to be entrusted to a tribunal which is an organ of the Federation as a whole. It would seem to follow that the Court should have seisin of justiciable disputes of every kind between the Federation and a Province or between two Provinces, and not only disputes of a strictly constitutional nature; but that in the case of disputes between the Federal Government and a State, between a State and a Province, or between two States, the dispute must necessarily be one arising in the federal sphere, that is to say, one in which a question of the interpretation of the constitution (using that expression in its broadest sense) is involved, since otherwise the jurisdiction would extend beyond the limits of the Treaties of cession which the States will have made with the Crown before entering the Federation. The Committee are disposed to think that decisions by the Court, given in the exercise of this original jurisdiction, should ordinarily be appealable to a Full Bench of the Court.

55. In the case of disputes arising between a private person and the Federation or one of the federal Units, the Committee see no reason why these should not come, in the first instance, before the appropriate Provincial or State Court, with an ultimate right of appeal, if the matter arises within the federal sphere, to the Federal Court, since it would obviously be oppressive to compel a private citizen who had a grievance, however small, against (say) his Provincial Government, to resort exclusively to Delhi, or wherever the seat of the Federal Court may be, for the purpose of obtaining justice. But even in the federal sphere the right of suit against
a State in its own Courts accorded to a citizen of that State must be regulated by the laws of that State, though the citizen who is given a right of suit by the State law could not be deprived of his right of access to the Federal Court by way of appeal, whatever form that appeal may take. In this connection, the Committee draw attention to the need of investing both Provinces and States with a juristic personality, for the purpose of enabling them to become parties to litigation in their own right. The Committee understand that, at the present time, no action lies against a Province of British India as such, and that no action can be brought against an Indian Prince in a British Indian Court save under very special conditions. On the other hand, the Committee are informed that, in some of the States, provision has already been made whereby proceedings can be taken against the State in its corporate capacity as distinguished from the Ruler of the State himself. This subject will require to be further examined.

56. The Federal Court ought also, in the practically unanimous opinion of the Committee, to have an exclusive appellate jurisdiction from every High Court, and from the final Court in every State, in all matters arising in the federal sphere, as defined above. A certain difference of opinion on questions of method has, however, to be recorded. The suggestion was made that some plan might be devised whereby anyone desiring to challenge the constitutional validity of a law passed by the Federal or a Provincial Legislature could obtain a legal decision on the matter at an early date after the passing of the Act, and that this might be done by means of a declaratory suit to which some public officer would, for obvious reasons, be a necessary party. The advantages of some such procedure are manifest, and the subject deserves further examination. Assuming, however, that legal proceedings of this kind are found possible, the Committee think it right that they should be confined to the Federal Court alone, at any rate where the validity of a Federal law is in issue, though there was a difference of opinion upon the question whether, in the case of a Provincial or State law, the proceedings might not be permitted in the first instance in the appropriate High Court or State Court. Where, however, a constitutional issue emerges in the course of any ordinary litigation, the tribunal which may have seisin of the case should have jurisdiction to decide it, subject always to an ultimate right of appeal from the State Court or High Court (if the case gets so far) to the Federal Court.

57. The form which the appeal should take might be left to be dealt with by Rules of Court; but, whatever form or forms are adopted, the Committee are clearly of opinion that there must be an ultimate appeal as of right to the Federal Court on any constitutional issue. Their attention was drawn to a very convenient procedure at present existing in British India whereby, when a question of title (C5225)
is raised in a Revenue Court, a case can be stated on that point only for the opinion of the Civil Court, proceedings in the Revenue Court being suspended until the decision of the Civil Court is given; and they think that the possibility of adopting a procedure of this kind might well be explored. They understand, in particular, that a procedure on these lines would be the procedure most acceptable to the States. The Committee are, however, impressed with the need for discouraging excessive litigation, and recommend therefore that no appeal should lie to the Federal Court, unless the constitutional point in issue has been clearly raised in the Court below.

58. The suggestion that the Federal Court should, for federal purposes, be invested with some kind of advisory jurisdiction, such as that conferred on the Privy Council by Section 4 of the Judicial Committee Act, 1833, met with general approval, and the Committee adopt the suggestion subject to certain conditions. In the first place, they are clear that the right to refer matters to the Court for an advisory opinion must be vested in the Governor-General; and secondly, they think that no question relating to a State ought to be referred without the consent of that State.

59. The Committee are of opinion that an appeal should not lie from the Federal Court to the Privy Council, except by leave of the Court itself, though the right of any person to petition the Crown for special leave to appeal, and the right of the Crown to grant such leave, of course, be preserved; some delegates were, however, of opinion that the Federal Court should be a final Court of Appeal. There would therefore be no right of appeal to the Privy Council direct from a High Court in any case where an appeal lay to the Federal Court. The Committee desire to emphasise here, in order to prevent any misunderstanding, that any right of appeal from the State Courts to the Federal Court and thence to the Privy Council in constitutional matters will be founded upon the consent of the Princes themselves, as expressed in the Treaties of cession into which they will enter with the Crown as a condition precedent to their entry into the Federation. There can be no question of any assumption by Parliament or by the Crown of a right to subject the States to an appellate jurisdiction otherwise than with their full consent and approval.

60. It will be necessary to provide that Federal, State and Provincial authorities shall accept judgments of the Court as binding upon themselves when they are parties to a dispute before it, and will also enforce the judgments of the Court within their respective territories. It will also be necessary to provide that every Provincial and State Court shall recognise as binding upon it all judgments of the Federal Court.
61. The Committee think that the Court should be created, and its composition and jurisdiction defined, by the Constitution Act itself. They are of opinion that it should consist of a Chief Justice and a fixed maximum number of Puisne Judges, who would be appointed by the Crown, would hold office during good behaviour, would retire at the age of 65, and would be removable before that age only on an Address passed by both Houses of the Legislature, and moved with the fiat of the Federal Advocate General. The question of the salaries and pensions of the Judges is a delicate one. The Committee are clear that the salaries, at whatever figure they may be fixed, should be non-votable and incapable of reduction during a Judge’s term of office; and it would be a convenience if the salaries could be fixed by the Constitution Act, or in accordance with some machinery provided by that Act. The Committee have no desire to suggest any extravagant figure, but they are bound to face facts; and they realise that, in the absence of adequate salaries, it is in the highest degree unlikely that the Federation will ever secure the services of Judges of the standing and quality required. They suggest that the matter might be referred to a small committee for investigation and report at a reasonably early date. With regard to the qualifications of the Federal Court Judges, the Committee suggest that the following should be eligible for appointment:—any barrister or advocate of fifteen years’ standing and any person who has been, for not less than five years, a Judge of a High Court or of a State Court, the qualifications for appointment to which are similar to those for a High Court.

62. The seat of the Court should be at Delhi, but power should be given to the Chief Justice, with the consent of the Governor-General, to appoint other places for the sittings of the Court as occasion may require. The Court must also have power to make Rules of Court regulating its procedure; these Rules should, after approval by the Governor-General, have statutory force. The power to regulate the procedure of the Court should include a power to make Rules enabling the Court to sit in more than one Division, if necessary. The appointment of the staff of the Court should be vested in the Chief Justice, acting on the advice of the Public Service Commission; but the number and salaries of the staff must, of course, be subject to the prior approval of the Governor-General.

63. A strong opinion was expressed in the Committee that the time had come for the creation of a Supreme Court for British India to which an appeal should lie from all Provincial High Courts in substitution for a direct appeal to the Privy Council. Appeals from the Court would lie to the Privy Council only with the leave of the Court or by special leave. The creation of such a Court is in the natural course of evolution, and the Committee adopt the suggestion in principle. A difference of opinion, however, manifested
itself on the method whereby such a Court should be brought into existence. There was a strong body of opinion amongst the British Indian Delegates to the effect that the Federal Court should be invested with this further jurisdiction, the proposal being that the Court should sit in two Divisions—one dealing with Federal matters and the other with appeals on all other matters from the Provincial High Courts. Other members of the Committee and, generally speaking, the States' representatives, dissented from this view, and were of the opinion that there should be a separate Supreme Court for British India on the ground that the Federal Court would be an all-India Court, while the Supreme Court's jurisdiction would be confined to British India; the mass of work with which it would have to cope would obscure its true functions as a Federal Court, and to that extent detract from its position and dignity as a Federal organ. It is no doubt the case that many more appeals would be taken to a Supreme Court situate in India than are at present taken to the Privy Council, and the Committee appreciate the force of this objection. But there would be no difficulty in reducing the appeals to a reasonable number by imposing more stringent restrictions upon the right of appeal. The Committee would deprecate the imposition on the finances of India of the cost of two separate Courts if this can possibly be avoided, and cannot disregard the possibility of conflicts between them. There is, lastly, at no time in any country a superfluity of the highest judicial talent, and the truer policy appears to them to be to concentrate rather than to dissipate judicial strength.

64. A question of very real difficulty upon which there is a divergence of view remains to be considered, viz., whether the Constitution Act itself should at once establish a Supreme Court or whether power should be given to the Federal Legislature to establish it either as a separate institution, or by conferring general appellate jurisdiction on the Federal Court as and when it may think proper so to do. The majority of the Committee is impressed with the need for proceeding cautiously in this matter, though recognising that the opportunity should not be lost of settling once and for all the general outlines of a Supreme Court scheme. The establishment of a Supreme Court, and the definition of its appellate jurisdiction are, they think, essentially matters for the Constitution Act, and it appears to them that, in the circumstances, it may be advisable to take a middle course. They recommend, therefore, that the Constitution Act should prescribe the jurisdiction and functions of the Supreme Court, and that the Federal Legislature should be given the power to adopt these provisions of the Constitution Act in the future, if it should think fit to do so. The majority of the Committee recommends this method on several grounds. In the first place, the establishment of the Court would in any event require a large increase in the
judiciary, and, in their view, it should be left to the Federal Legislature of the future to decide whether the additional expense should be incurred or not. Secondly, the whole subject is one which requires much expert examination, and it may be desirable that experience should first be gained in the working of the Federal Court in its more restricted jurisdiction. Thirdly, the functions of the Federal Court will be of such great importance, especially in the early days of the Federation, that, in the opinion of the majority, it would be unwise to run the risk of either overburdening it prematurely with work, or of weakening its position by setting up in another sphere a Court which might be regarded as a rival.

A substantial minority of the Committee is strongly of the opinion that the establishment of a Supreme Court for British India is a matter of urgent necessity, and that such a Court should be set up by the Constitution Act itself without necessarily waiting until the time when the Federation comes into being.

65. A proposal to invest the Supreme Court above described with jurisdiction to act as a Court of Criminal Appeal for the whole of British India also found a certain measure of support. It is clear that, even if a right of appeal to this Court only in the graver criminal cases were given, the work of the Court, and therefore the number of Judges, would be enormously increased. The Committee had not the time at their disposal to enter into a close examination of the question whether, in principle, a Court of Criminal Appeal for the whole of British India is desirable; and they do not feel themselves able to express any opinion upon the matter, though they recognise its great importance. For the same reason that they hesitate to recommend the immediate establishment by the Constitution itself of a Supreme Court for appeals in civil matters from the High Courts of British India, the majority is unable to recommend the immediate establishment of a Court of Criminal Appeal. This matter is one which, in their opinion, must be left to the future Federal Legislature to consider; and if that Legislature should be of opinion that such a Court is required, there will be no difficulty, if it should be thought desirable, in investing the Federal Court, or the separate Supreme Court, as the case may be, with the necessary additional jurisdiction. Some members drew attention to the fact that a Court invested with the various jurisdictions which were suggested in the course of the Committee's discussions would have to consist of probably as many as twenty or thirty Judges, and in all likelihood of many more.

66. The subject of the Provincial High Courts in British India was also touched upon in the course of the Committee's discussions, and they think it right to record their views on one or two points of importance connected with this subject. In the first place, the
Committee are of opinion that High Court Judges should continue to be appointed by the Crown. Secondly, they think that the existing law which requires certain proportions of each High Court Bench to be barristers or members of the Indian Civil Service should cease to have effect, though they would maintain the existing qualifications for appointment to the Bench; and they recommend that the office of Chief Justice should be thrown open to any Puisne Judge or any person qualified to be appointed a Puisne Judge. The practice of appointing temporary additional Judges ought, in the opinion of the Committee, to be discontinued.

Signed, on behalf of the Committee,

SANKEY.

St. James's Palace, London.
9th November, 1931.
APPENDIX.


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1. The terms of reference of the sub-Committee were as follows:—

"To examine and report upon the general principles upon which the financial resources and obligations of India should be apportioned between the Federation, the British Indian Units jointly and severally, and the States Units."
2. The following Delegates were selected to serve on the sub-Committee:

- Lord Peel (Chairman),
- Major Elliot, M.P.,
- Mr. Pethick-Lawrence, M.P.,
- *Major the Hon. Oliver Stanley, M.P.,
- Sir Akbar Hydari,
- Sir Mirza Ismail,
- Colonel Haksar,
- Rao Bahadur Krishnama Chari,
- *Mr. Benthall,
- Sir Maneckjee Dadabhoy,
- Mr. Iyengar,
- Sir Sayed Sultan Ahmed, and
- Dr. Shafa'at Ahmad Khan.

* Sir Robert Hamilton, M.P., subsequently took the place of Major Stanley, and Sir C. E. Wood that of Mr. Benthall.

3. The sub-Committee met on the 28th, 29th and 30th September, and the 1st, 2nd, 6th, 7th, 8th and 9th October, and has authorised me to present this Report.

4. **Conditions of the Problem.**—In considering the principles upon which the general financial scheme for the new Federation should be framed, we are necessarily at a disadvantage because it is impossible for us, with the time at our disposal, to make even tentative estimates of the probable revenue and expenditure of the Federation and its constituent Units. Any theoretical scheme for the division of resources and obligations should, before being embodied in the constitution, be put to the test of a careful examination of its probable results by some body which is fully equipped for the task. We accordingly recommend that, with the least possible delay after the conclusion of the present Session of this Conference, an Expert Committee should be constituted for the purpose of working out in detail a financial scheme for the Federation,† taking as its starting-point the general proposals contained in our Report (subject, of course, to their acceptance by the Federal Structure Committee and the Conference). The Expert Committee must have for its guidance some general principles of the kind set out below; but it should be free to make alternative suggestions if, on closer examination of the facts, a probability is disclosed that any general principle laid down by us would, in practice, prove unworkable. In addition to the Committee's duty of framing a general scheme, there are also many specific points, some of which we mention below, on which its advice should be sought.

† See also paragraph 26.
Such a body will necessarily be in a better position than we are to examine estimates of future revenue and expenditure and to take these into account in arriving at its recommendations. Even this Committee, however, will be unable to foresee the future so accurately that its judgment regarding immediate financial prospects can safely be made the basis of a rigid constitutional scheme. The difficulty is particularly acute in the adverse economic circumstances which now prevail, and which seem likely to continue for some time to come. It will therefore be necessary to aim at a considerable degree of elasticity in the financial framework. Whatever success in attaining this object can be achieved, we still consider it important that the Conference, when considering the question of constituent powers, should be specially careful to ensure that amendment of the constitution in this respect is not so hedged with difficulties as to be almost impracticable. Changing industrial and economic conditions, for example, may, at a date earlier than might now be anticipated, make it imperative to modify the financial scheme adopted at the outset.

While we are thus unable to frame a Budget for the Federation or its Units, it is impossible to enunciate even general principles without making an assumption, however rough, as to the financial obligations of the new governments. The provisional classification of subjects suggested by the Federal Structure Committee at the last Session of the Conference involves no change of importance, from a financial point of view, in the functions of the Provinces (or States) and of the government at the Centre (whether in its “Federal” or “Central” aspect). Federation may bring with it certain fresh charges (e.g., expenses of the Federal Court), or possibly, on the other hand, certain administrative economies; but these variations do not appear likely to reach such magnitude as would bring about any fundamental change in the relative positions of the Units and the Centre in regard to financial requirements. Provincial expenditure, more particularly on “nation-building” services, may expand into fresh channels, whereas the range of Federal expenditure is more confined. It is essential, however, that all the governments should exercise the strictest economy and that their scale of expenditure should be reviewed and reduced to a minimum. But although there may be a natural and a proper tendency for Provincial and States’ expenditure to increase, despite economies, and for Federal expenditure perhaps to decrease, it is important to remember that the Federation will have to bear, in the main, the financial burden of any grave crisis, and that it is especially on the credit of the Federal Government that the whole financial stability of India—its constituent parts no less than the Federation—must, in the end, depend. We are therefore bound to point out that there is danger in assuming that in no circumstances will additional burdens fall on the Federal Government.
Bearing the above in mind, we have started from the standpoint—

1. that it is undesirable to disturb the existing distribution of resources between the various governments in India unless, as we have found in some cases, there are imperative reasons for making a change;

2. that, at all events to begin with, the Federation and its constituent Units are likely to require all their present resources (and, indeed, to need fresh sources of revenue); so that, on the whole, it is improbable that any considerable head of revenue could be surrendered initially by any of the governments without the acquisition of alternative resources.

With these preliminary observations we now proceed to set forth what we conceive are the principles to be followed.

5. "Central" Charges.—It was generally accepted in the Federal Structure sub-Committee at the last Session that the aim of the new constitution should be to eliminate, as far as possible, any "Central" subjects; but, so far as could be foreseen, it seemed likely that a residue of such subjects (notably certain civil and criminal legislation) would remain indefinitely. It appears probable, however, that the ideal will be more easily attained on the financial side. "Central" expenditure, broadly speaking, will consist of three categories:

1. Expenditure on "Central" Departments.

2. A share in pre-Federation obligations in respect of civil pensions.

3. Possibly a share of the service of the pre-Federation debt.

(2) and (3) are, of course, items which will ultimately vanish.

Expenditure under (1) will be simply for those few departments and institutions (e.g., Archaeological Department and Zoological Survey) which were not included at the last Session within the category of Federal subjects. It may well be that an agreement could be reached to federalise these items; but, in any case, the expenditure on them is relatively insignificant. In strict theory there should be included among "Central" charges a proportion of the cost of the Federal General Administration expenditure in respect of such "Central" business as "Central" legislation. The amount, however, would probably be so trifling as to make this a needless complication.

As regards (2), the allocation of "Central" civil pension charges (not debited to the Provinces) between Federal and "Central" is a point which should be investigated by the Expert Committee. There seems no reason why the Federation should not be charged in respect of the pensions of officers who were previously employed...
on duties which, in future, will fall within the scope of Federal activities; but there may be a case for making the balance a “Central” charge.

6. Pre-Federation Debt.—The third possible item in the “Central” charges—a share in the service of the pre-Federation debt—raises more important issues than the other two. The Public Debt of India has been incurred through loans which have not, at the time of their issue, been allocated for expenditure on specific heads. It is certain that, in any case, from the point of view of the investor, the security must remain, as before, the “revenues of India”—that is to say, the future revenues of the Federation and of the Provinces but not of the individual States. No classification of pre-Federation debt as Federal and “Central” for constitutional purposes could be contemplated of such a kind as to affect the position of the lender.

The Departmental Memorandum of the Government of India has attempted to classify the greater part of the total Public Debt as debt covered by commercial or liquid assets together with a few miscellaneous items of a similar character, leaving a residue of Rs. 172 crores which, it is suggested, should be classed as “Central.” We think that this classification may be misleading for the following reasons.

The borrowings of governments are, in the nature of things, not restricted to what is required for investment in commercial or productive undertakings, and it is probable that no important country, even at the time of its fullest prosperity, has been in a position to show the whole of its debt as covered by assets of this nature. It would be absurd to suggest that every country has therefore been continuously insolvent, as would be the case of a commercial company which showed a deficiency of assets in comparison with liabilities. A country’s borrowing is conducted on the security of its credit and of its revenues, actual and potential.

The Government of India, like most other governments, has at times had to increase its debt owing to revenue deficits. Such debt, legitimately incurred in tiding over periods of difficulty or emergency, forms a reasonable charge on the whole undertaking of government, even when not represented by specific tangible assets. On the other hand, large allocations have consistently been made from revenue for the reduction of debt and for capital expenditure. It is doubtful whether any other country could make so favourable a comparison as India between the total volume of its debt and the value of its productive assets.

Even as regards the productive assets included in the Memorandum, it will be observed that the figure against Railways, for instance, is not an estimate of their actual commercial value as a going concern, but represents merely the capital invested. The Railway proceeds in
a normal year are sufficient for the payment of a contribution to
general revenues of over Rs. 5 crores, in addition to meeting the
whole of the interest charges on the Railway debt. The capitalised
value of this additional profit, though it cannot be estimated with
exactitude, might well amount to as much as Rs. 100 crores.

Again, the valuable assets of the Government of India are not
limited to those which actually earn profits. The Federal Authority
will presumably succeed to the whole of the buildings and public
works of all kinds which at present are the property of the Central
Government. The replacement value of these is, of course, an enor­
mous sum, though there are no exact data at hand for evaluating it.
Further, while such assets do not directly produce revenue, they
represent a saving of annual expenditure.

Moreover, although the loans and other obligations are shown as
partially offset by certain assets, it will be understood that loans are
normally raised for general purposes and not earmarked for specific
objects ; their proceeds go into a general pool. The particular items
of debt cannot, therefore, be set off against individual assets ; and it
would clearly be impossible to relate the “balance” of Rs. 172
crores, mentioned above, to any particular loan or other obligation.

It therefore seems to us that, if it were found, after investigation
by the Expert Committee, that all the obligations were covered by
assets, the whole of the pre-Federation debt should be taken over
by the Federation. While, however, this seems to us to be the probable
result of a close investigation, we do not rule out the possibility of a
finding by that Committee that a certain proportion of the pre-
Federation debt should equitably be classified in the first instance
as “ Central ” ; that is to say, that its service (including a due pro­
portion of sinking fund charges) should be taken to be a “ Central ”
and not a Federal charge.

The question of post-Federation debt is considered in paragraph
22 below.

7. Service of “ Central” Charges.—The only important existing
source of the Government of India’s revenue which is derived solely
from British India is Income-tax. The problem of how Income-tax
should be treated is discussed more fully in paragraph 15 below ;
but it is clear that, whatever may be the amount of the “ Central ”
charges discussed in the preceding paragraphs, it should be deducted
as a first charge against the Income-tax collected solely from the
British Indian Provinces, and against any other revenue collected by
the Federal Government but derived solely from British India.

8. Allocation of Resources between the Federation and its Constituent
Units.—It is obvious that, if there is to be an equitable apportion­
mint of burdens and smooth working of the constitutional machin,
the Federal resources should, as far as possible, be confined to revenues derived alike from the inhabitants of the Provinces and of the States, and which can be raised either without any action on the part of the individual States or by an agreement with them of simple character, readily enforceable. This principle implies, very roughly, that the Federal sources of revenue should be confined to "indirect" taxes. If, however, a "direct" tax could be found which complied with the above conditions, it would be highly desirable to include this among the Federal resources, for the following reasons.

The revenue from Customs will inevitably decline if there is an intensification of protective policy, and the profits of indigenous companies (and also, of course, the yield of the Income-tax on these profits) will presumably increase. Moreover, "indirect" taxes tend to impose a relatively heavy burden on the poorer classes, and a Federal system of purely "indirect" taxation might unduly expose the Federal Government to criticism on this ground. We have been informed that federations which began with only "indirect" taxation have been compelled by force of circumstances to levy a tax on incomes or profits of companies in some form or other; and that, in at least two cases (United States of America and Switzerland), a formal Amendment of the Constitution was necessary for this purpose.

9. Corporation Tax.—The most obvious "direct" Federal tax is Income-tax. We think that it would be desirable, if it were possible, that some of the Income-tax receipts in all the Units of the Federation should, in case of necessity, be available as a Federal resource; but we recognise that this is, in general, a development which must be left to the future and depend on free negotiation between the Federal Government and the federating States subsequent to federation.

As regards the Corporation tax (now called the Super-tax on Companies), however, we suggest that, if the necessity of such a reinforcement of Federal revenues is established, this tax should be included in the list of Federal taxes; and we hope that the States will agree to this principle.

If federalisation of the Corporation tax were not accepted by the States, it would continue to be treated as a British Indian source of revenue.

10. Classification of Revenues.—In view of the difficulty of classifying taxes in general terms which permit of precise legal interpretation, and of the necessity, in a federation, of leaving no doubt as to where the constitutional power of imposing a certain tax lies, we think the most satisfactory solution would be that the Federal taxes
and the Provincial taxes should be fully scheduled. We would suggest the following initial classification (apart from Income-tax, which is discussed separately in paragraph 15 below):

**Federal.**
- External Customs, including Export duties.
- Salt.
- Export Opium.
- Excises on articles on which Customs duties are imposed (with the exception of Excises on Alcohol, Narcotics* and Drugs).
- Receipts from Federal Railways, Federal Posts and Telegraphs, and other Federal commercial undertakings (see further under paragraph 25 below).
- Profits of Federal Currency.
- Corporation tax (see paragraph 9 above).
- Contributions from Provinces (see paragraph 16 below).
- Contributions from States (see paragraph 17 below).

**Provincial.**
- Land revenue.
- Excises on Alcohol, Narcotics* and Drugs.
- Stamps, with the possible exception of Commercial Stamps (see paragraph 13 below).
- Forests.
- Provincial commercial undertakings.
- Succession duties, if any.
- Terminal taxes, if any (see paragraph 13 below).
- The first seven taxes in the present First Schedule to the Scheduled Taxes Rules.

* It is open to doubt whether "Narcotics" should, for this purpose, include Tobacco.

We think that these lists should be examined by the Expert Committee, not only in order to review them generally, but also to expand and particularise them, and to include in them all sources of taxation at present used in British India or under contemplation.

11. Relations of Federal and State Taxation—It is necessary, at this stage, to refer to certain forms of taxation now in force in the States, apart from the special cases discussed in paragraph 20, which may conflict with taxes assigned to the Federation, or which may be economically undesirable from the point of view of the Federation as a whole. The first and most important of these is the internal Customs tariff which many States levy at their frontiers. One aim of the Federation, in our opinion, should be the gradual disappearance of any tax, now in force in a State, which is similar in character to a Federal tax and so may impinge on Federal receipts. At the same
time we recognise that it may be impossible for the States in question to surrender, either immediately or in the near future, large sources of existing revenue, without the acquisition of fresh resources; nor would it seem to be in general an equitable plan for the Federation to attempt to buy up, so to speak, the existing rights of the States in such a matter. This would simply mean that, in the general interests of economic unity and to facilitate trade, a tax would be imposed on the Federation as a whole in order to relieve the inhabitants of the States. The abolition of these taxes must therefore be left to the discretion of the States, to be effected in course of time as alternative sources of revenue become available. Subject to examination by the Expert Committee, it seems likely that one possible such source is the Terminal tax referred to in paragraph 13.

There may be some instances, e.g. Corporation tax and Tobacco excise, in which States already levy taxes which, under the general scheme, it is suggested, might be federalised. Special adjustments will be necessary to bring these States into line with the Federation.

12. **Unspecified Taxes.**—Under the scheme outlined in paragraph 10 above, the problem of "residuary powers" of taxation, in its ordinary sense, would seem to disappear; and we are left simply with the question, who should have the power of raising taxes hitherto unconsidered in India. It is obvious that, in dealing with taxes of a nature which is at present unforeseen, the correct solution cannot be to allocate them in advance either finally to the Federation or finally to the constituent Units. A proper decision could only be taken when the nature of the tax was known. There would be great advantages in vesting the Federation with the right to levy such taxes, while empowering it to assign the right to the Units in particular cases, since such a process would be far easier than that of vesting the right in the Units and asking them, when necessary, to surrender it to the Federation. There are, however, constitutional objections to the proposal that the Federation should have power to impose unscheduled taxes on all Units of the Federation; and many of us feel that it is not possible to do more than to provide that the constitutional right to levy any unscheduled tax should rest with the Provinces or States, subject to the condition that the levy of the tax does not conflict with the Federal scheme of taxation.

13. **Taxation—Miscellaneous.**—Sir Walter Layton recommended the use of Terminal taxes as an additional resource for the Provinces. The Government of India, on the other hand, have pointed out the difficulties which beset this proposal. Once again, such complicated issues are raised that expert scrutiny is essential. We agree that, if such taxes were levied, the proceeds should go to the Provinces and the States. In any case we think that both the rates and the general conditions under which such taxes would be imposed should be subject to the control of the Federal Government and Legislature.
Transit duties, whether in the Provinces or in the federating States, should be specifically forbidden.

The Provinces should be debarred from levying internal Customs. (The position as regards the States is examined in paragraph 11 above.)

There is much to be said for federalising Commercial Stamps on the lines of various proposals made in the past; but we have not examined the question sufficiently to justify us in reaching a definite conclusion.

It will be understood that the powers of taxation enjoyed by Provincial Governments or States should be subject to the overriding consideration that they should not be exercised in such a manner as to conflict with the international obligations of the Federal Government under any Commercial Treaty or International Convention.

No form of taxation should, we think, be levied by any Unit of the Federation on the property of the Federal Government. The precise form in which this principle should be expressed should be examined by the Expert Committee.

14. Grants to Constituent Units.—It seems important that the constitution should, in one respect, be less rigid than the existing one, under which it has been authoritatively held that there is no power to devote Central resources to the Provinces or Provincial resources to the Centre. It should, we think, be open to the Federal Government, with the assent of the Federal Legislature, not only to make grants to Provinces or States for specified purposes, but also, in the event of its ultimately finding that Federal revenues yield an apparently permanent surplus, to be free, as a possible alternative to reduction of taxation, to allocate the surplus proceeds to the constituent Units of the Federation, both States and British Indian Provinces. It appears desirable that the constitution itself should lay down the proportions in which funds thus available should be divided among the Units, whether according to their respective revenues, or to population, or to some other criterion—a point on which the Expert Committee will presumably advise.

Whatever the automatic basis for distribution, we consider that it should be subject to an exception in the case of States which impose taxes of a character similar to Federal taxes (e.g. internal Customs); and it should be open to the Federal Government to distribute to such a State its share of the surplus funds only if that State agreed to reduce equivalently the tax at the abolition of which the Federation was aiming.

The reverse process should also be possible. Any Province, with the assent of its Legislature, should be free to make a grant for any purpose to the Federal Government.
15. Taxes on Income.—We now take up the question of the treatment of taxes on Income other than Corporation tax, which, we have suggested in paragraph 9 above, should be Federal. As stated in paragraph 7, something may have to be deducted from the proceeds of these taxes, in the first instance, on account of “Central” charges, if any.

We are agreed that such taxes should still be collected from the whole of British India by one centralised administrative service. Most of us are also of the opinion that uniformity of rate should be maintained, since variations of rate may lead to unfortunate economic consequences, such as discrimination between industries in different Provinces. Some of us take the opposite view, both because of the constitutional difficulty mentioned below and because of the difficulty of securing uniformity in all Units. The subject is clearly one to which the Expert Committee should devote much attention.

In any case, we are all of the opinion that the net proceeds should, subject to the special provisions mentioned below, be re-distributed to the Provinces. On any other basis it will be impossible to secure, even ultimately, a uniformity of Federal burdens as between the Provinces and the federating States, or to avoid a clash of conflicting interests in the Federal Legislature when there is a question of raising or lowering the level of taxation. The distribution of the proceeds of Income-tax among the Provinces (even though there may initially be countervailing Contributions to the Federal Government, as proposed in the next paragraph) may also form a very convenient means of alleviating the burden of two or three of the Provinces which, under the present system, are universally admitted to be poorer than the others. With this in view, the Expert Committee should recommend by what criteria the proceeds of Income-tax should be allocated among the Provinces—whether, for example, on the basis of collection or origin, or according to population, or by some other method or combination of methods.

Those of us who recommend that Income-tax should be collected by one agency at a uniform rate to be fixed by the Federal Legislature, though the proceeds are distributed to the Units, recognise that we are, of course, departing from the principle—to which we generally attach considerable importance—that the right to impose and administer a tax should be vested in the authority which receives the proceeds. This seems to us inevitable; but the difficulty might be met, at all events partially, if the Federal Finance Minister, before introducing any proposal to vary the Income-tax rate, were required to consult Provincial Finance Ministers. The procedure in the Federal Legislature, when dealing with an Income-tax Bill, should follow the procedure to be laid down for other “Central” legislation affecting directly only British India.

A further point arising in connection with Income-tax, of such complicated nature that we are unable to make a definite recommendation regarding it, is the possibility of empowering individual
Provinces, if they so desire, to raise, or appropriate the proceeds of, a tax on agricultural incomes. We suggest that this point might be referred to the Expert Committee for investigation.

16. Provincial Contributions.—We have, subject to certain reservations, proposed the allocation to the Provinces of the proceeds of taxes on Income, without, so far, any corresponding reinforcement for the Federal Government. If the Expert Committee unexpectedly found that Federal resources were such as to give a secure prospect of recurring revenues sufficient to meet this loss immediately (and also a loss in respect of the heads dealt with in paragraph 17 below), many difficulties would, of course, be removed. But, on the provisional basis set out in paragraph 4, we are bound to assume that there may be a substantial Federal deficit, due to the allocation of Income-tax to the Provinces. The deficit, in so far as it arises from the above cause, should, we suggest, be met by Contributions from the Provinces, to be divided between them either on the basis of their respective revenues or of population, or according to some other defined method. The Expert Committee should consider what is the most appropriate basis. This basis need not necessarily be the same as that on which the Income-tax proceeds are distributed. Differentiation between the two methods might be used as a means of partially adjusting the burden on Provinces which are specially hard hit by the existing distribution of resources between them.

We further propose that, not merely should it be the declared object of the Federal Government, as its position improves, to reduce and ultimately extinguish these Contributions, but the constitution should specifically provide for their extinction by the Federal Government by annual stages over a definite period, say, ten or fifteen years.

17. States’ Contributions.—In the scheme proposed above, the Federal burdens will be spread over all the Units of the Federation in a precisely similar manner except for:

(a) The above-mentioned Contributions from the Provinces, until such time as they are finally abolished;

(b) such direct or indirect contributions as are, or have been, made by certain States, of a kind which have no counterpart in British India; and

(c) varying measures of immunity in respect of Customs and Salt enjoyed by certain States.

We now turn to consider what the States’ contributions are, or may be; but, at the outset, we would lay down the general principle that, subject to certain exceptions specified below, the direct or indirect contributions from the States referred to at (b) should be wiped out *pars pascu* with the Provincial Contributions mentioned in the preceding paragraph.
18. Cash Contributions from States and Ceded Territories.—The direct or indirect contributions from the States just referred to may arise, or are alleged to arise, under the following heads:

(i) Cash contributions;
(ii) Value of ceded territories,* and
(iii) Contributions in kind for Defence by the maintenance of State Forces.

(i) Cash contributions from States (till recently known as tributes) have arisen in many different ways, and it has been impossible for us to examine the cases of individual States. Nevertheless, we think that there is, generally speaking, no place for contributions of a feudal nature under the new Federal Constitution; and only the probability of a lack of Federal resources at the outset prevents our recommending their immediate abolition. We definitely propose that they should be wiped out *part passu* with the Provincial Contributions discussed in paragraph 16 above. Meanwhile, there seem to us to be certain cases in which real hardship is inflicted by the relative magnitude of the burden of the cash contributions; and we suggest that it might be possible, without excessive loss being thrown on the Federal Government, to remit at once that part of any contribution which is in excess of 5 per cent. of the total revenues of a State.

Apart from this, the circumstances under which the contributions have been levied vary so much that it is necessary for the Expert Committee to undertake (what it has been impossible for us to execute) a detailed examination of each individual case, and, with the above general principles in mind, to express an opinion as to what would be equitable treatment for each of the States in question.

(ii) Without the necessary statistics, we are unable to investigate in detail the claim of the States that, through having ceded territory, some of them will be liquidating a liability in respect of Federal burdens. Here again we propose that the Expert Committee should examine the whole question, and pronounce an opinion as to the equities in each individual case.

19. State Forces.—(iii) Any attempt to assess the financial value to the Federation of the State Forces would raise many intricate problems into which it has been impossible for us to enter. Close consultation with the Military Authorities and with individual States would be necessary before any solution of this problem could be found. The maintenance and availability of these Forces is at present optional for the States concerned; and we think it likely that, before any credit was given to a State on account of the Force which it maintains, the Federal Authorities would, at all events, wish to prescribe:

(a) That the Forces should be efficient according to a standard of which the Military Authorities should be the judge, and should also be required for purposes connected with the general Defence scheme of India; and

* This term does not include the leased territory of Berar.
that these Forces should, by some permanent arrangement, be made available for services to be determined by the competent Military Authorities.

In any case, we regard this as a separate question which should be taken up between the Military and Financial Authorities of the Federal Government on the one hand, and the individual States on the other. We further think that any financial adjustment should be a matter of bargaining between the parties concerned, and should be treated as a separate matter—not on the lines of (a) and (b) of paragraph 17.

20. Maritime States and Kashmir.—These States, being on the frontiers of India, are in a special position as regards the question of external Customs duties. Here again, we feel that it is impossible to deprive States of revenue of which they are already in possession. One principle which we would lay down is that, in all cases, the Import tariff at the States' Ports should be not less than that at Ports in the rest of India. The question whether Maritime States should agree to the administration of Customs at their Ports being taken over by the Federal Department is obviously one of great importance, but hardly comes within the sphere of our enquiry.

Our general conception of the problem is that the Treaties or agreements, which vary widely in the different cases, must be taken as they stand, and that any decision as to what are the existing rights of a State, in those instances in which they are now in dispute, should be determined separately, with the least possible delay, and not by the Expert Committee. We think, however, that the latter should investigate the position in each State on its ascertained existing rights, and should express an opinion as to what commutation it would be worth while for the Federal Government to offer to the State for the extinction of any special privilege which it now enjoys. In doing so, the Committee might allow for any contributions of special value which a State may be making to the Federal resources. With this opinion before them, we think it should be left to the Federal Authorities, if they think fit, to negotiate with each State for the surrender of existing rights. The Expert Committee should also attempt to determine what, in the absence of any such surrender, would be the amount which Federal revenues lost owing to the existence of the special right of the State; and this valuation should be taken into account by the Federal Government whenever any question arose, as suggested in paragraph 14 above, of the Federation's distributing surplus revenue over the Federal Units.

21. Emergency Powers of the Federal Government.—In order to ensure that the Federation is not left resourceless in a grave emergency, and also to secure the object referred to in the next paragraph, we regard it as important that there should be an emergency power
in the Federal Government, with the approval of the Federal Legislature, to call for contributions from all the Units of the Federation on some principle of allocation to be based on examination by the Expert Committee.

22. Borrowing Powers of the Units and the Security of Post- Federation Debt.—In view of the degree of autonomy with which, we understand, it is likely that Provinces will be clothed, it seems to us that it will probably be inappropriate, at all events as regards internal borrowing, that there should be any power in the Federal Government to exercise complete control over borrowing by a Province. There must apparently be a constitutional right in a Province to raise loans in India upon the security of its own revenues, leaving it, if need be, to learn by experience that a Province with unsatisfactory finances will only be able to borrow, if at all, at extreme rates. We would, however, give the Federal Government a suitably restricted power of control over the time at which Provinces should issue their loans, so as to prevent any interference with other issues, whether Federal or Provincial. But, although this should be the constitutional position, we think it highly undesirable that, in practice, Provincial borrowings and Federal borrowings should be co-ordinated only to this limited extent; and we feel little doubt that, as hitherto, Provinces will find it desirable to obtain the greater part of their capital requirements through the Government at the Centre.

It has been suggested that loans, both for the Federation itself and for the Units, should be raised by a Federal Loans Board or Council, consisting of representatives of the Federal Government and of the Governments of the Units and of the Reserve Bank. On the other hand, it is argued that an authority of this kind could not raise a loan, since it could not pledge the revenues of the country, though it might be useful in an advisory capacity when the Federal Government was dealing with applications made by Provinces for loans. We are of opinion that these suggestions should be examined by the Expert Committee, which should be asked to make definite recommendations as to the machinery to be set up for arranging loans. In doing so, they will no doubt take into account the experience of Australia and other countries.

In order to secure that loans are raised at the cheapest rates, it is desirable that the security should be as wide as possible; and we therefore suggest that, in the interests both of the Federation and of the Units, all loans raised by the Federal Authority should, in the future, like those of the Government of India in the past, be secured not only on the revenues of the Federation but also on the revenues of the Provinces of British India. To ensure that this is not an unreality, it is necessary to have some such provision as is proposed in the preceding paragraph, under which there is an ultimate right in the Federation to call for contributions from the Units.
There would be no objection to federating Indian States, if they so desired, obtaining funds from the Federal Government on conditions similar to those applying to the Provinces, and being eligible for representation on the Advisory Board, provided that those participating were prepared specifically to recognise this right of the Federation to call for contributions from themselves as well as from other Units.

We are of the opinion that there should be no power in the Units to borrow externally without the consent of the Federal Government.

23. Provincial Balances.—We consider that, until a Reserve Bank has been established, the Federal Government should act as banker for the Provincial Governments on a commercial basis. On the establishment of a Reserve Bank, Provincial Balances should be kept with that institution.

24. Chief Commissioners’ Provinces.—It is suggested that the revenue and expenditure of these areas, though shown in the accounts under separate heads for each area, should fall within the scope of the Federal Budget. Generally speaking, we think that the States have as great an interest in these areas as has British India; and we believe that those areas which are likely to be in deficit will probably be found to be so for Federal reasons, such as special connection with Defence, or, in the case of Delhi, its containing the Federal Capital.

It is, of course, proposed that the North-West Frontier Province, which is now a Chief Commissioner’s Province, should become a Governor’s Province. There must, however, be a considerable gap between the revenue derived from the ordinary Provincial sources and the normal expenditure of the Province; and it is proposed that this should be filled by a subvention. We contemplate that this subvention should be found from the Federal Budget, as the causes of the Provincial deficit are intimately linked with matters of Federal concern, viz., Defence and Foreign Policy.

25. Commercial Departments.—Some of us are of the opinion that the Railways (and possibly other departments, such as Posts and Telegraphs) should be conducted on such a basis as to secure a more complete separation from Federal revenues than is at present the case, and that, after paying interest and meeting the charge at present incurred by the Government of India in respect of reduction of Railway debt, they should keep their own profits and should work on a basis which, in the long run, would yield neither profit nor loss. From our standpoint it is to be noticed that such a plan would involve an important change in the basis of the security for the existing debt; but the proposal is closely connected with that made at the last Session of the Conference, that a Statutory Railway
Authority should be established. It thus raises very important constitutional issues which are beyond the province of this sub-Committee and must be fully examined elsewhere.

26. Proposals regarding Expert Committees.—The Expert Committee, the appointment of which we have recommended in paragraph 4 above, will, in our view, have a most important rôle to play. We anticipate that it might be difficult to commit to one small body the examination of all the matters in regard to which we have judged that detailed scrutiny will be required.

We therefore advocate a division of the field of enquiry into two parts. The principal object of the first enquiry would be a general survey of the problem and an examination of the questions dealt with in paragraphs 5 to 17 and 21 to 25 of our Report. The second enquiry should relate mainly to the States, and would require considerable historical research in addition to the compilation and scrutiny of statistics. Under this head it will be necessary to review in detail the questions dealt with in paragraphs 17 to 20 of our Report.

We consider that efficiency and promptitude would best be served by allotting these two fields of enquiry to two separate Committees, the work of which might perhaps be co-ordinated by a common Chairman. A precedent for a somewhat similar device can be found in the arrangements made for the work of the Franchise Committee and Functions Committee of 1918–19.

Signed, on behalf of the sub-Committee,

PEEL.

St. James's Palace, London,
9th October, 1931.
INDIAN RURAL TRADE CONFERENCE
(Second Session)

THIRD REPORT OF FEDERAL STRUCTURE COMMITTEE.
(Paper No. F.T.C.20).

CORRIGENDUM TO C.P. 282 (31).
It is requested that the undermentioned footnote may be inserted at the end of the Third Report which was circulated on November 16th. This amendment will, of course, be incorporated in the Report as finally printed.

Note. One member of the Committee raised the important question of empowering the Federal Legislature to deal with certain aspects of labour questions and of empowering the Federal Government and Legislature to deal with questions connected with the ratification of International Labour Conventions.

A solution of the difficulties to which he has drawn attention will have to be found when the precise relationship between the legislative powers of the Federal and Provincial Legislatures is finally determined. In this particular matter there has not been opportunity this session to advance further than the general conclusions reached at the last session, and the Committee are unable to report in detail upon it. Further consideration will have to be given to it.

(Signed) R.H.A.CARTER.

Secretariat-General,
St. James's Palace,
S.W.1.

27th November, 1931.