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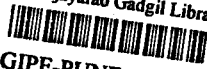
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**THE EVOLUTION OF PROVINCIAL
FINANCE IN BRITISH INDIA**

THE EVOLUTION OF PROVINCIAL FINANCE IN BRITISH INDIA

A STUDY IN THE PROVINCIAL
DECENTRALIZATION OF
IMPERIAL FINANCE

BY

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WITH A FOREWORD BY

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Dedicated to
HIS HIGHNESS SHRI SAYAJIRAO GAIKAWAD
MAHARAJA OF BARODA
AS A TOKEN OF MY GRATITUDE FOR HIS HELP IN THE
MATTER OF MY EDUCATION

4668

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PREFACE

FOR a long time to come students will be saved the conventional humiliation of making an apology for presenting a study of Indian Finance or Economics. But it will, on the other hand, be necessary, I fear, for an equally long period, for them to tender an apology for the shortcomings of their respective investigations. Even when the treatment of a subject is analytical, a good analytical study often requires an historical setting. Unfortunately no spade-work has been done in the field of Indian Finance. Consequently the difficulties which beset a pioneer in that field are immense. There is occasionally the difficulty owing to the antecedents of some point not having been quite completely elucidated. Often there is the apprehension of some error having crept in, and, when there is hardly anyone to save the student from it, there is nothing but to smart under a sense of irritating affliction. Not very seldom does it happen that a pioneer student is jubilant over his find of material bearing on his subject, but it is not without a long and wearisome search that he is able to sift the grain from the chaff. Again, sources sometimes prove false guides, so that a perusal of them only ends in a considerable waste of time and energy.

Precisely these have been the difficulties besetting the present task. There are no books to prepare

the student for his work and hardly any savant to lighten his labour or set him on the proper track. Notwithstanding such odds, an attempt is made to make this study thorough without being too detailed. This has rendered the undertaking quite a laborious one. But I do not wish to speak of the labour that is involved, nor do I wish to astonish the reader with what might appear to be a formidable list of books and documents consulted in the preparation of this monograph. What I am anxious to speak of are its shortcomings. There are indeed many of them which a well-versed critic may spot out. It is my hope that they are not of such a character as seriously to impair the value which this monograph may otherwise be said to possess. My regrets are with regard to only a few of them. I have specified a date as to when Local Decentralization of Finance commenced in India ; but I feel that that date may not be the earliest and that there may be a date earlier than that one given by me. I wish I had settled that point finally. But that would have been a task analogous to that of searching for a needle in a haystack, and it is doubtful whether the value of that result would have been commensurate with that labour. Besides, although I am not confident of my date, my feeling is that later researches may after all confirm my statement. Another matter which I have not dealt with, but which I would have liked to have dealt with, was the inter-relation of Provincial and Local Finance. This I had originally planned to do, but left pursuing it because I found that the chief subject I was dealing with, namely, the Provincial Decentralization of Imperial Finance, began to be overlaid

by facts and arguments not germane to that topic. These shortcomings will, however, be removed by a supplementary monograph on Local Finance in British India, which is well under way and which I hope to publish before long. Occasional repetitions may also be pointed out as a defect of this monograph. That they should be avoided is all very well. But where economy in the words of explanation are likely to obscure, repetitions such as are unavoidable must be justified, for the interests of clarification should always outweigh the tedium they involve.

I cannot conclude this preface without thanking Mr. Robinson, the Financial Secretary at the India Office, for many valuable suggestions and for the loan of many important documents bearing on the subject. I am also thankful to Prof. Cannan, of the University of London, who has read the rough draft of a small part of the manuscript. My debt to Prof. Seligman, my teacher at Columbia University, is of course immense: for from him I learned my first lessons in the theory of Public Finance. I am obliged to my friend Mr. C. S. Deolé for assistance afforded in the dreary task of reading the proofs.

FOREWORD

THE problem discussed by Mr. Ambedkar in his excellent dissertation is one that is arousing a growing interest in all parts of the world. [From the very beginning we find fiscal burdens imposed by both central and local governments. As soon as there was a political organization, the conduct of war on the one hand and the provision of local protection and convenience on the other called for expenditures on the part of both state and local authorities. It was only at a later period that there was interpolated between the local and the central political organizations the intermediate form which Mr. Ambedkar calls the provincial government.] The names applied to these various classes of expenditure differ with the authorities themselves. In India we speak of local, provincial, and imperial expenditure; in Germany, of local, state, and imperial expenditure; in the United States and Switzerland, of local, state, and federal expenditure; in Australia, of local, state, and commonwealth expenditure; in South Africa and Canada, of local, provincial, and federal expenditure; and in France, of local, departmental, and general expenditure. In some cases, as in the British Empire, there is being developed a still more comprehensive class of expenditures, borne by the empire at large.

The character and importance of these various classes of expenditure and the relations between them are undergoing a continual change, due to an alteration in the functions of government. This is

itself largely due to a change in the general economic conditions, resulting in a gradual modification either of political structure or of administrative activity. In some countries, as in Canada, Argentine and Brazil, the provinces are really a creation of the central government; in other countries, as in the United States, Germany, and Switzerland, the federal government is the creation of the originally sovereign states. In some countries the intermediate (provincial or state) government is suffering a loss of importance as compared with the local or central governments; in other countries, the reverse is true.

With the increasing pressure of taxation and the development under modern democracies of augmented governmental functions, the problem of the equitable distribution of burden among these various forms of government is becoming more or less acute. What Mr. Ambedkar calls assignments, assigned revenue, and shared revenue, is symptomatic of the choice of methods in all countries. One of three fundamental plans must be pursued. Either the central or the provincial government may be maintained by the other, according to the relative degree of strength: in former times, in the United States, and in Germany the states were supposed to support the central government, either wholly or in large measure; in modern times, in Canada and Australia, the reverse is true. Or, secondly, distinct revenues may be allocated to the separate governments: until recently the federal government in the United States, Germany, and Switzerland was supported primarily by indirect taxes; the state governments by direct taxes. Or, thirdly, the revenues may be collected by one government and a portion

of the proceeds allotted to the other: there are many instances of a state or provincial tax being shared with the federal government, and still more examples of a federal or central tax being shared with the state or provincial government. In the United States at present the proper disposition of the inheritance tax as between state and federal government is fast becoming a burning question; in Germany the fiscal relations of state and federal government are in the forefront of political discussion.

The value of Mr. Ambedkar's contribution to this discussion lies in the objective recitation of the facts and the impartial analysis of the interesting development that has taken place in his native country. The lessons are applicable to other countries as well; nowhere, to my knowledge, has such a detailed study of the underlying principles been made.

It is true that only half of the picture is presented. For the situation has everywhere been complicated by the entrance of the local authorities into the field; and by their claims to fiscal consideration as compared with both state (provincial) and general (federal) demands. In the United States, for instance, the now widely debated problem of financing the schools is largely dependent for its solution on the proper answer to be given to the question of fiscal interrelations. To this question Mr. Ambedkar proposes to devote himself in a subsequent study. If he succeeds in illumining that situation as successfully as he here deals with the initial problem, he will lay us all under still deeper obligations.

EDWIN R. A. SELIGMAN

COLUMBIA UNIVERSITY, NEW YORK
October, 1924

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INTRODUCTION

DEFINITION AND OUTLINE OF THE SUBJECT

A STUDENT of Indian Finance has two chief sources of information and guidance open to him. One is the Annual Budget Statement, and the other is the annual volume of Finance and Revenue Accounts. Though separately issued, the two are really companion volumes inasmuch as the Financial Statement forms, so to speak, an exhaustive explanatory memorandum of the annual financial transactions, the details of which are recorded in the volume of Finance and Revenue Accounts.

Helpful as these sources are, they are not without their puzzles. A reference to the latest volume of Finance and Revenue Accounts will show that the accounts therein are classified under four different categories :—(1) Imperial, (2) Provincial, (3) Incorporated Local, and (4) Excluded Local. But this is by no means uniformly so. For instance, a volume of the same series before 1870 will not be found to contain the accounts called “Provincial,” nor will the accounts styled “Local” be found in any volume prior to 1863. Similarly, any volume of the Financial Statements before 1870 will be found to divide the financial transactions covered therein into—Imperial and Local only. But a volume of the same series after 1908 curiously

enough groups the accounts not under Imperial and Local but under (1) Imperial, and (2) Provincial, while the Financial Statements after 1921 cover only the Imperial Transactions. Nothing is more confusing to a beginner than the entrance of the new, and the exit of the old, categories of accounts.¹ The natural question that he will ask is, how did these different categories evolve, and how are they related to one another?

In the present study an endeavour is made to explain the rise and growth of one of them, namely, the "Provincial." But in order that there may be no difficulty in following the argument it is deemed advisable to preface this study with an outline defining its subject-matter and indicating the inter-relations of the parts into which it is divided. To facilitate a thorough understanding of the subject the study is divided into four parts, *each* one dealing with the Origin, Development and Organization of Provincial Finance and the final form in which it

¹ It is surprising that the category of accounts, called "Excluded Local," which is to be found in the volume of Finance and Revenue Accounts, never appears in the Financial Statement. The author has not been able to trace the reason for its exclusion. In the *Madras Manual* (Vol. I, Chapter V, pp. 467-9) it is argued that the ground for the exclusion is technical and consists in the circumstance that the Excluded Funds are not collected by the ordinary revenue collecting agency of the Central Government and are not subject to its interference. Another technical ground may also be found in a ruling given in the third edition of the Civil Account Code (p. 137), according to which Funds were called Excluded, i.e. from the Financial Statement, because they were not required to be lodged in the Government Treasury. But a ruling on the same point given in the seventh and latest edition (p. 122) of the same seems to imply that every public fund must of necessity be lodged in a Government Treasury. The more probable explanation is that given in the *Moral and Material Progress Report* for 1882-3 (Part I, p. 107), where it is said that these funds have no place in General Finance because they "consist chiefly of special trusts and endowments."

was cast by the constitutional changes of 1919. In Part I a somewhat thorny, untrodden and yet necessary ground has been covered in order to give a complete idea of the origin of Provincial Finance. While due homage is paid to the adage which requires students of the present to study the past, nothing more than the past of the present has been dealt with. In Chapter I, Part I, an attempt is made to present a picture of the system of Finance as it existed before the inauguration of the Provincial Finance and to state the causes that called for a change in its organization. In Chapter II a rival system of Finance proposed during the period of reconstruction is brought to light and shown why it failed of general acceptance. Chapter III is devoted to the discussion of a plan which was a compromise between the existing system and its rival, and the circumstances which forced its reception.

Having explained the Origin in Part I, the Development of Provincial Finance is made the subject of Part II. How far the arrangement followed in Part I is helpful must in the absence of anything to compare with it be left to the opinion of the reader. In regard to Part II, however, it is to be noted that the arrangement is different from what is adopted in the only fragmentary sketch published on the subject of Provincial Finance in 1887 by the late Justice Ranade. As will be seen from a perusal of Part II, one of the features of Provincial Finance was that the revenues and charges incorporated into the Provincial Budgets were revised every fifth year. Justice Ranade in his pamphlet, which simply covers the ground traversed in Part II of this study, and that too up to 1882 only, has taken this feature as

a norm by which to mark off the different stages in the growth of Provincial Finance from one to another. Consequently, each quinquennial period to him becomes a stage, and in his hands the history of Provincial Finance falls into as many stages as the quinquenniums into which it can be divided. It may, however, be submitted that if every revision had changed the fundamentals of Provincial Finance, such an arrangement would not have been illogical. But as a matter of fact, Provincial Finance did not change its hue at every revision. What the revisions did was to temper the wind to the shorn lamb. If the history of the development of Provincial Finance is to be divided into stages according to the changes in the fundamental basis thereof, then emphasis has to be laid on features altogether different in character. Writers on the theory of Public Finance seem to conceive the subject as though it were primarily a matter of equity in taxation and economy in expenditure. But a Chancellor of the Exchequer finance is eminently practical with a problem to solve, namely, how to bring about an equilibrium in the Budget. If we scan the history of Provincial Finance in British India with a view to discover the method of meeting the problem of equilibrium in Provincial Budgets and the changes introduced in it from time to time, we shall find that Provincial Finance has evolved through three distinct stages, each with its own mode of supply, namely, Assignments, Assigned Revenues, and Shared Revenues. Consequently, instead of following the mechanical plan of Justice Ranade, it is believed to be more logical and instructive to divide the stages in the growth of Provincial Finance

according to the method of supply to the Provincial Governments adopted by the Government of India. Consequently, Part II, which deals with the Development of Provincial Finance, is divided into three Chapters: (1) Budget by Assignment, (2) Budget by Assigned Revenues, and (3) Budget by Shared Revenues.

This discussion of the Origin and Development of Provincial Finance is followed in Part III by an examination of its Organization. Chapter VII in Part III is devoted to the analysis of the hitherto neglected rules of limitations on the financial powers of Provincial Governments primarily to bring out the fact that Provincial Finance was not independent in its organization. The analysis of the true position of Provincial Finance is, however, reserved for Chapter VIII, in which the conclusion is fortified by a reference to the character of these limitations, that, notwithstanding the high-sounding appellation of Provincial Finance, there were neither provincial revenues nor provincial services as separate from Imperial revenues and Imperial services, so that instead of being federal in its organization the system remained essentially imperial. Chapter IX discusses how far it was possible to enlarge the scope of Provincial Finance without jeopardy to the constitutional responsibilities of the Government of India under the old law.

Part IV is a discussion of the changes introduced into the mechanism of Provincial Finance by the Reforms Act of 1919. Chapter X of this Part is devoted to the analysis of the causes which led to these changes. In Chapter XI a full description of the changes effected by the new law is given,

while Chapter XII forms a critique of the new regime.

In view of the fact that students of Indian Finance ordinarily content themselves with the phrase "Decentralization of Finance," to indicate Provincial Finance, a word of explanation in justification of what may rather be called the too cumbersome title of this study. No student of Indian Finance, who is sufficiently acquainted with the branching off of the system in different directions, will fail to mark the inadequacy of the phrase Decentralization of Finance to mean Provincial Finance. If there were in the Indian system only the Provincial Decentralization there would have been no necessity to labour for a new title. As a matter of fact, the starting points of decentralization are by no means the same, and the systems evolved through it are quite different in character. For instance, the centre of decentralization and the systems evolved by the policy of decentralization brought into operation in 1855 were different from the centre and the systems evolved therefrom by the policy of decentralization initiated in 1870. Again, the centre which is gradually being decentralized since 1892, be it noted, is different from those affected by the decentralization of 1855 or 1870. To put it more clearly, the decentralization of 1855 was the decentralization of *Indian* Finance resulting in—

(I) the separation of Local from Imperial Finance.

The decentralization of 1870 was the decentralization of *Imperial* Finance resulting in—

(II) the separation of Provincial from Imperial Finance.

And the decentralization commencing from 1882 is the decentralization of *Provincial* Finance resulting in—

(III) the separation of Local from Provincial Finance.

Obviously then, "Decentralization of Finance" far from being indicative of Provincial Finance, is a general name for this variegated and multifarious process of decentralization described above, and it cannot but be confusing to use as a title to the study of one line of decentralization a phrase which can be generically applied to all the three lines of decentralization distinguished above. In order, therefore, that this study may not be taken to pertain to a line of decentralization other than the one it purports to investigate, it has been thought proper to designate it "The Evolution of Provincial Finance in British India" with a sub-title, "A Study in the Provincial Decentralization of Imperial Finance," where the words Provincial and Imperial must be read with the emphasis due to them. How careless the phraseology often is may be instanced by the fact that Justice Ranade's pamphlet referred to above is styled "Decentralization of Provincial Finance." Although it deals with the development of Provincial Finance, it is likely to be passed over by the student, for its title implies that its subject-matter must be the growth of Local Finance. If Justice Ranade had been conscious of the varieties of decentralization, he would have probably realized that the title of his pamphlet was false to its contents.

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