

**The A-B-C**  
**OF**  
**Indian Government Finance**

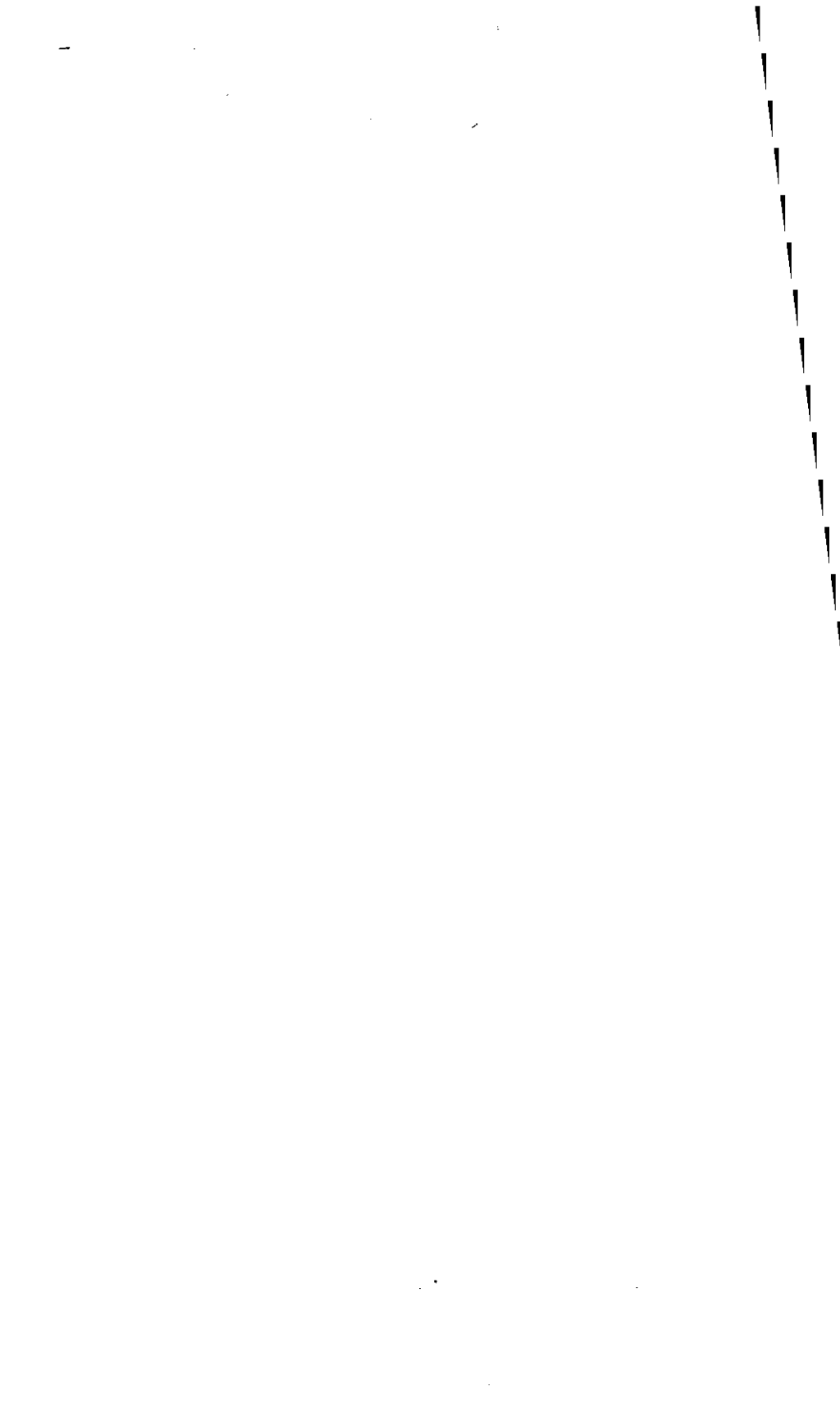
**BY**  
**P. K. WATTAL**  
**Accountant General, Madras**





## **PREFACE.**

Although the Book is printed at the Government of India Press and published by the Central Publication Branch, the Government of India do not accept any responsibility for the contents of the Book.



## CONTENTS

	Pages.
<b>CHAPTER I.—FINANCIAL CONTROL</b>	1—13
Introductory	1—2
Finance under the new constitution	2—8
Agencies of financial control	6
(1) The Legislature.	6—7
(2) The Executive Government	7—8
(3) The Finance Department	8
Functions of the Finance Department in relation to—	
(a) Expenditure	8—10
(b) Revenue	10
(c) Other matters	10—11
Relation of finance to administration	11—12
(4) The Audit Departments	12
General observations	12—13
<b>CHAPTER II.—GOVERNMENT ACCOUNTS AND THEIR AUDIT</b>	14—27
Importance of public accounts	14
Essentials of public accounts	14—15
The Auditor General	15—16
General principles underlying Government accounts	16—17
General outline of the system of Government accounts	17—18
(i) Initial accounts in Treasuries	18—19
(ii) Classification	19—20
(iii) Compilation	20—21
Allocation of expenditure between capital and revenue	21—23
Audit	23
(i) Audit of receipts	23—24
(ii) Audit of expenditure	24—25
(iii) Audit of stores and stock	25—26
(iv) Local Fund Audit	26
Relation of audit to administration	26—27
<b>CHAPTER III.—THE PREPARATION OF THE BUDGET</b>	28—36
Meaning of the word ' budget '	28
Importance of the budget	28—29
General Rules	29—32
Preparation of the budget	32—36
<b>CHAPTER IV.—THE VOTING OF THE BUDGET</b>	37—46
Presentation of the budget	37
Demands for Grants	38
The Estimates in the Legislature	38
The general discussion of the budget	38—39
The voting of grants	39—40
Procedure for the voting of grants	40—41
Non-votable expenditure	41—42
Motions on the votings of grants	43
The schedule of authenticated expenditure	43—44
Supplementary demand	44

	Pages.
Token demands . . . . .	44
The voting of taxes . . . . .	44—45
The Finance Bill . . . . .	45
The Provisional Collection of Taxes Act . . . . .	46
<b>CHAPTER V.—BUDGET CONTROL SYSTEM AND REVIEW OF CONTROL</b> . . . . .	<b>47—53</b>
Distribution of grants . . . . .	47
Sub-heads of appropriation . . . . .	47—48
Appropriations and re-appropriations . . . . .	48—49
Control of expenditure . . . . .	49—50
Review of Control . . . . .	50
Public Accounts Committee . . . . .	50—51
Finance Accounts . . . . .	51—52
General observations . . . . .	52—53
<b>CHAPTER VI.—PUBLIC DEBT</b> . . . . .	<b>54—59</b>
Volume of debt . . . . .	54
Classification of debt . . . . .	54—55
Ways and means advances . . . . .	55
Treasury Bills . . . . .	55—56
Unfunded Debt . . . . .	56
Productive and unproductive debt . . . . .	56—57
Redemption of public debt . . . . .	57—59
Administration of the public debt . . . . .	59
<b>CHAPTER VII.—CASH BALANCES</b> . . . . .	<b>60—64</b>
General considerations . . . . .	60
The Reserve Bank of India . . . . .	61
The main problem . . . . .	61—63
Currency chests . . . . .	63
Home Treasury Balances . . . . .	64
<b>CHAPTER VIII.—FEDERAL FINANCE</b> . . . . .	<b>65—75</b>
General Principles . . . . .	65—66
(a) Uniformity . . . . .	66
(b) Independence . . . . .	66
(c) Adequacy . . . . .	66—67
(d) Administrative expediency . . . . .	67—68
Distribution of resources under the new Constitution . . . . .	68
The Legislative lists . . . . .	68—71
Residuary powers of taxation . . . . .	71
Assignment of Central taxes to provinces . . . . .	72—73
Grants from the Centre to the provinces . . . . .	73
Financial adjustments . . . . .	74
(1) Decentralisation of balances . . . . .	74
(2) Consolidation of pre-autonomy debt . . . . .	74
(3) Cancellation of debt . . . . .	74
Financial results of the new settlement . . . . .	74—75

## CHAPTER I.—FINANCIAL CONTROL

**Introductory.**—Finance is the fuel of the administrative machine. Just as no motor car can run without petrol, so no government can function without finance. Apart from this, it is necessary that public revenue should be raised in an equitable manner and spent economically so that the tax-payer may get full value for his money. In this sense, sound public finance is the fundamental basis of good government.

The principles governing public finance closely resemble private finance in certain points and differ from it in certain others. Mr. Micawber, who never could keep his finances in order and was always dependent on something turning up, enunciated the golden rule of private finance in the following words :—

“If a man has twenty pounds a year for his income and spends nineteen pounds, nineteen shillings and six pence, he will be happy, but if he spends twenty pounds one shilling, he will be miserable.” The same rule applies to public finance. It is just as much necessary for a State as for a private individual to keep within its income. In some essential points, however, State economy is distinct from the economy of the private individual. An individual works with the idea of making a profit : the greater the profit he makes the more successful he is supposed to be. A State exists for the performance of certain services and not for the sake of making profits. The ideal of State economy is to establish a balance between receipts and expenditure. A State that has over a series of years very large surpluses is only slightly less ill-managed than one with large deficits. The best practical rule is to aim at a slight excess of receipts over outlay in order to prevent the chance of a deficit. The second main point of difference is that while an individual need not look beyond his own life-time, the statesman has to regard himself as trustee for the future and so regulate financial policy as not to impair the patrimony of the State. An individual is obliged to recognise the fact of death and to adjust his affairs accordingly. To take an extreme case, a man who has no one to depend upon him may, without criticism from anybody, convert his property into a life-annuity. The statesman cannot do this. He is called upon to manage the property of the people whose interests endure in perpetuity. In matters of public finance it is incumbent that each succeeding administration shall find as broad a field from which to supply its needs and as fruitful a source of supply as the administration that preceded it.

It is generally accepted that democracy is an expensive form of government. This observation is as old as democracy itself, but during the last twenty to twenty-five years the expensiveness of democratic administration, both State and local, has become more and more manifest. India is no exception to this general tendency. With the progressive advance towards a democratic form of government, the expenses of the administration have increased in India to an appreciable extent. In 1913-14, for instance, the total central and provincial expenditure came to Rs. 125 crores. In 1936-37, the year prior to the inauguration of the new constitution, the total central and provincial expenditure was Rs. 211

crores ; or, in other words, there was an increase of expenditure by 69 per cent. in 23 years. There are several causes for this increase in expenditure, of which not the least important are the expansion of legislative bodies, separation of political from administrative functions, creation of ministries and parliamentary offices, splitting up of certain provinces into smaller units, expenditure on bigger buildings for the new Legislatures and its offices, etc. The margin for fresh taxation is not large, and the provincial governments are faced with increasing demands for expenditure on nation-building services. At the same time, they have, in the majority of the provinces at any rate, pledged themselves to extinction of the excise revenue and generous concessions in land revenue, two of the main sources of provincial revenue. The Centre has equally difficult problems to face, such as the modernisation of defence side by side with the possibility of a dwindling customs revenue. Financial administration, at the Centre and in the provinces, will therefore require careful handling in the near future, even if nothing untoward happens.

An attempt is made in the following pages to explain the system of public finance in the hope that it will help to form correct ideas about financial administration and thus contribute to the formation of informed public opinion, which is essential for the successful conduct of financial affairs in a democracy.

**Finance under the new constitution.**—It is a truism to say that the authority which controls the public purse controls the administration. Self-government can have no meaning if there are no adequate revenues, or if the authority in respect of raising revenue or sanctioning expenditure is placed elsewhere. It seems necessary, therefore, to see what freedom in matters of finance the Centre and the provinces enjoy under the new constitution.

The first thing to notice is the change in status. Previously, the provincial and Central governments acted on delegated authority and as the agents of the Secretary of State, who was vested with general powers of superintendence and control over them. Under the Government of India Act, 1935, there has been a demarcation of the Central and provincial spheres and the executive authority of the Crown, which was previously vested in the Secretary of State, is vested directly in the Central Government in respect of central matters and in the provincial governments in respect of provincial matters. The term 'executive authority' includes financial authority, in so far as raising revenue, or sanctioning expenditure, or borrowing money, etc., are concerned. So that, whereas previously whenever any financial action was taken, governments had to ask themselves, 'Have we been given the power to do this?' the presumption now is in their favour unless it can be definitely shown that they are debarred by law from exercising any particular power.

This change in status is even more clearly noticeable in respect of property and public revenues. Whereas, previously all the property of the Crown in India, moveable or immoveable, was vested in the Secretary of State in Council and in him alone, simultaneously with the demarcation of provincial and central subjects, under the new constitution, there has also been a demarcation of property, and Central and Provincial governments have been vested with full legal rights over property which naturally



appertains to their respective spheres. They can now sue, and be sued, in courts of law in their own name in respect of such property and not on behalf of the Secretary of State, as was the case prior to the Reforms.

Similarly, with regard to revenues. Ever since 1858, when the Crown took over the administration of Indian affairs from the East India Company, the revenues of India were a single and indivisible entity and were vested in the Secretary of State in Council, who was responsible to the British Parliament for their administration. The law knew of no such terms as 'the revenues of the Government of India' or 'the revenues of a province', and no government had any statutory right or title to the moneys which it raised. But now all this has undergone a radical change. The revenues of India have been split up into 'the revenues of the Federation' and 'the revenues of a province' and full legal rights have been vested in the Federal and the provincial governments respectively in regard to them. The manner in which the apportionment of resources between the Centre and the provinces has been made is dealt with in the chapter on Federal Finance.

Under the former Government of India Acts, no Government, Central or provincial, had any power to sanction expenditure, except in accordance with rules issued by the Secretary of State in Council from time to time, which were technically known as 'audit resolutions'. Prior to the Montagu-Chelmsford reforms, the sanction of the Secretary of State was required to any expenditure or grant of a loan which was of an unusual nature or was devoted to objects outside the ordinary work of administration. These terms were deliberately kept vague and sanctions given by the Government of India and the provincial governments to expenditure which would today be regarded as perfectly legitimate were frequently objected to in audit and the sanction of the Secretary of State was considered necessary to matters such as the erection of a reading room in a civil station, the provision of a recreation ground for Government employees, expenditure on publicity work, grant of advances for industrial purposes, etc.

Under the Montagu-Chelmsford reforms, some subjects were transferred to the control of the provincial legislatures and in relation to expenditure on these subjects provincial governments were given very wide powers. The financial powers of the Government of India were also enlarged, but the general control of the Secretary of State over expenditure on Central and provincial reserved subjects was kept intact.

With the inauguration of the new constitution from 1st April 1937, provincial governments have been made responsible to their own legislature. They now possess full powers in regard to provincial expenditure, except in certain cases. Expenditure on services recruited by the Secretary of State is subject to the control of the Secretary of State. Expenditure on the allowances of Governors and the Judges of the High Court is regulated by Orders-in-Council of His Majesty. In respect of certain matters of provincial administration, Governors have the power to act otherwise than on the advice of their Ministers. In taking such action Governors may have to spend public money and they are fully empowered to do so on their own authority, subject to the control of the Governor.

General and the Secretary of State. In regard to all other matters provincial governments are perfectly free to incur such expenditure as they consider necessary, provided they can get the Legislature to accord its sanction to it.

Prior to the Montagu-Chelmsford reforms, provincial governments had no power to borrow at all in the open market. Under the Montagu-Chelmsford reforms, they were given restricted powers. The purposes for which loans could be raised were specified and the approval of the Government of India was necessary in each case. Under the Government of India Act, 1935, provinces have no power to borrow outside India without the consent of the Centre, but they are free to borrow in India for any purpose they like, if they are not indebted to the Central Government. As several provinces are so indebted they are under a statutory obligation to obtain the consent of the Central Government. The consent may be granted to such conditions if any, as the Central Government may think fit to impose but it should not be unreasonably withheld.

From the above review of the constitutional position, it will be clear that a provincial government is entirely free to decide whether its budget is to be a surplus or a deficit one, what taxes it considers necessary, and if it is not indebted to the Central Government, for what purposes and on what terms a loan may be raised, etc. In all these matters its discretion is unfettered by the intervention of any external authority; or, to use a familiar phrase, the responsibility for 'safeguarding the financial stability and credit' of a province is vested entirely in its Ministry. The Governor of the province has no special responsibility in the matter.

Only two other matters remain to be considered, namely, cash balances, and accounts and audit. Under the Montagu-Chelmsford reforms, provincial government accounts were separated from the Central Government accounts, but the balances of provincial governments were required to be kept in the custody of the Central Government. Provincial governments, in other words, had not the privilege of banking accounts of their own. They had not attained to man's estate. This restriction has now been removed. Provincial governments have now separate accounts with the Reserve Bank of India and the cash balance of the Central Government does not include, as was the case before, money belonging to the provincial governments. They have full control over the disposal of their balances, subject to their keeping certain prescribed minimum balances with the Reserve Bank, to which a reference is made in another chapter.

Provincial accounts are quite separate from Central accounts. But the agency which keeps these accounts and audits them, namely, the Auditor General of India and his staff is paid for from Central revenues and control over the staff in matters of administration is vested partly in the Auditor-General and partly, in the Central Government. The Act, however, leaves it to a provincial government to decide whether it will have an accounts and audit department of its own, in which case it will have to pay for it from its own revenues. The source from which the Auditor-General and his staff are paid has, however, nothing to do with the manner in which accounts are kept and audited. In the performance of his account and audit duties, the Auditor-General is as much independent of the Central Government as he is of the provincial governments

and it may truly be said that he is as much the Auditor-General of each province as he is the Auditor-General of the Centre.

The position at the Centre is somewhat different. The Central Government also derives its executive authority by a direct grant from the Crown and is no longer in law the agent of the Secretary of State. It has its own revenues and powers to raise moneys and spend them. But it is in a stage of transition, pending the establishment of Federation. It is responsible to the Secretary of State and not to the Central Legislature. Consequently, control over central finance is, in point of fact, vested in the Secretary of State, very much the same as was the case before.

With the establishment of Federation, the Central Government will become responsible to the Legislature, for administration as well as finance, except in respect of defence, external affairs and ecclesiastical affairs. Financial control in respect of defence, external affairs and ecclesiastical affairs, will vest in the Governor-General, who will be subject to the control of the Secretary of State. So far as transferred subjects are concerned, the position with regard to financial control will be generally the same as in the provinces, with some important exceptions. As in the provinces, expenditure on the services recruited by the Secretary of State, on the allowances of the Governor-General, and on the Judges of the Federal Court will not be subject to the control of the Federal Ministry. Like the provincial Governors, the Governor-General will have the power to spend money in regard to matters within the transferred sphere in respect of which he is authorised by the Government of India Act, or any rule or order having the force of law, to act otherwise than on the advice of his Ministers. But in some respects his financial powers will be wider than those of provincial Governors. This is due to special circumstances which do not exist in the provinces. In the first place, there is no dyarchy in the provinces, whereas in the Federation there will be reserved and transferred subjects, and the expenditure on account of reserved subjects will form a considerable proportion of the total Federal expenditure. The purse will, however, be joint, that is to say, the entire revenue collected for the Federation will be kept in one account, which will be under the control of the Ministry. From this joint purse funds will have to be found for both reserved and transferred subjects. It will, therefore, be necessary for the Governor-General specially to make sure that there is at all times enough money in the Federal treasury to meet the requirements of his reserved departments.

Secondly, the provinces have no sterling debt, like the Centre. This debt is of considerable size and has been raised by the Secretary of State on the authority of Acts of Parliament. At the time these loans were raised the revenues of India were absolutely under the control of the Secretary of State and it can be argued that had the investors any idea that at some future date the British Government would hand over its responsibility in respect of Indian revenues to an elected Ministry in India they would not have so readily come forward to give those moneys to the Secretary of State. Even in ordinary life we see that if a person lends money to another on an estate and he hands over the estate to some one else the creditor generally asks, and is entitled to ask, for fresh or further guarantees.

Thirdly, the provinces have not to deal with the difficult and complicated questions of currency and exchange. The Central Government, with its income all in rupees, has to meet a large expenditure annually in sterling and so long as there is an adequate excess of exports over imports, the necessary finance can be found without difficulty. But when exports fall and exchange shows signs of weakness, it is not so easy. The value of the rupee in terms of sterling has to be maintained so as not to damage the credit of India in the world's money markets. Even a slight fall in the rate of exchange adds considerably to the burden of Government expenditure in terms of rupees and creates uncertainty in the minds of those engaged in trade and industry.

For these reasons the Governor-General has been given special powers in matters of finance. He will generally be entitled to see that expenditure is kept within revenue in ordinary times, that loans, external or internal, are not raised on such terms and for such purposes as would prejudicially affect the credit of the country, and that a sound exchange and currency policy is being pursued. To assist the Governor-General in the discharge of these duties he will have a Financial Adviser, whose advice will be equally available to the Federal Finance Minister, when sought for.

**Agencies of financial control.**—In all parliamentary systems, there are, as a rule, the following four agencies for the control of public finance :—

- (1) the Legislature,
- (2) the Executive Government,
- (3) the Finance Department,
- (4) the Audit Department.

The part played by each is briefly described below :—

**The Legislature.**—The main function of the Legislature in connection with finance is to vote supply. It is this power in the matter of supply which gives the Legislature its real control over the Executive. Initiative in matters of finance is, however, vested in the Executive and not in the Legislature. It is for the executive to say how much money it needs for the purpose of carrying on the administration in any particular year. The Legislature may say to the Executive that it is asking for too much and reduce the amount or cut it out altogether. But it may not put in fresh items of expenditure and thus add to the total burden to be borne by the tax-payer beyond what is considered absolutely necessary by the Executive. This is a safeguard provided against the tendency to extravagance inherent in democratic assemblies, to which a reference has been made at the beginning of this chapter.

Should the Executive consider that any proposed reduction or omission by the Legislature of the amount demanded would materially affect the discharge of its responsibilities, it may treat it as a question of no confidence. The carrying of any such motion would ordinarily result in the Government going out of office and the formation of a new Government.

This is briefly, the function of the Legislature in relation to expenditure which is subject to its vote. There are, however, several classes of expenditure which, under the Government of India Act, are not subject to the vote of the Legislature. Provision for such items is made entirely on the responsibility of the Executive and the Legislature has no power to make any alteration therein.

For fresh taxation legislation is generally necessary and, therefore, the Legislature has to give its approval. Here also, as in the case of expenditure the initiative rests with the Executive. The Executive proposes taxation, the Legislature may either refuse its sanction, or reduce the taxation proposed, but it may not increase it.

Taxation proposals are generally taken up after the voting of expenditure. Accordingly, in proposing reductions of taxation, the Legislature has to consider that as it has voted a certain amount for the expenses of the administration, it must give the Government sufficient funds to enable it to meet the expenditure voted.

In relation to borrowing, the Legislature has, at present, no powers at all, except to the extent that its vote is taken also for expenditure proposed to be met from loan funds. Borrowing in India is done entirely on the responsibility of the Executive. In England, Ministers of the Crown have to obtain Parliamentary sanction and borrowing is restricted to amounts and purposes fixed by Parliamentary Acts. The Government of India Act authorises the Legislature to fix limits within which borrowing by the Executive may be carried on, but, so far as is known, no such Act has yet been passed by any of the new Legislatures.

Suggestions are frequently made that the financial control of the Legislature should be made more stringent and more real, but persons who have experience of the working of democratic systems seriously doubt whether such a step would produce any reduction in expenditure. On the contrary, it might lead to greater expenditure and increased taxation. People are now not so keen on reduction in expenditure, they want expansion of the activities of Government in all directions. Such expansion necessarily means more taxation.

**The Executive Government.**—Under a system of joint responsibility of the Executive to the Legislature as prevails in the provinces, it is only natural that control in all matters of policy, in financial as in administration, should vest in the Government as a whole and not in any one department of Government.

Questions of financial policy may arise at any time in day to day administration, but it is generally when the budget is under preparation that the financial programme of the Government for the coming year is decided upon. To what extent fresh schemes of expenditure proposed by each department may be admitted, how the funds to meet such expenditure are to be obtained, what new taxes may be proposed for the consideration of the Legislature, and how much may be met by borrowing are all matters of policy in which the Government as a whole is concerned. Apart from these questions, there are other matters no less important in day to day financial administration, such as fixing the financial powers of each administrative authority, reductions or increases in salaries, allowances and

pensions of government servants, etc., whose effect is felt over the entire administration generally. These also come to be determined by the Government. It will, therefore, be obvious that the spirit of economy must prevail in the Government as a body, and not in any particular department alone such as the Finance Department, for any machinery of financial control to succeed in achieving its object.

**The Finance Department.**—The administration of the public finances is the concern of one particular department of the Executive Government known as the Finance Department. It is asking too much of human nature to expect that administrative departments, keen on expanding their activities and with so much of useful work to do, will put economy first. But economy is necessary at every stage however tedious and however unpopular. If the work of enforcing economy is to be done with efficiency, it must be given to a separate department, which is unconnected with any spending department. Hence the need for a division of functions and for an independence and detachment as great as possible in the position of the economising department.

A strong finance department is one of the fundamentals of good administration, whatever be the form of government. Under the Montagu-Chelmsford Constitution, the finance department in the provinces was given a statutory position with defined functions and powers. That was considered necessary as finance was a reserved subject but the functions of the finance department extended to transferred as well as reserved subjects. With the transfer of the control of all provincial subjects including finance, under the new constitution, there was no longer any need for a special statutory position for the finance department. The finance department is now one of the several other departments of government, whose business is regulated by rules framed by Governors of provinces under Section 59\* of the Act. The Finance Department has not, however, suffered by the change, as it continues to enjoy the same powers and exercises the same functions as it did under the Montagu-Chelmsford Constitution.

**Functions of the Finance Department in relation to (a) expenditure.**—It has been said above that the Finance Department is the custodian of economy. Its first and foremost function in this sphere is to consider and judge any proposal made by another department which will have the effect of imposing a new or increased charge on the public revenue (e.g., creating a new post or raising the salary of an existing one) or which will involve relinquishment of revenue. Such proposals may arise for examination either at the time of the preparation of the budget or in the course of a financial year. The heads of Departments submitting the proposals are required to indicate the order of urgency in respect of the various proposals submitted by them and also to give full details of the estimated additional expenditure or loss of revenue, except in the case of building schemes for which sketch plans and approximate estimates are generally considered sufficient. The Finance Department is entitled to examine and advise on all such proposals and to decline to provide funds in the budget or otherwise, for any proposal which has not been so examined. Proposals involving recurring expenditure, such as increase in

\*[Section 17 in the case of the Federation.]

establishments, are examined with great care in the Finance Department. The Government then decide, with reference to the funds available, which of the new schemes examined by the Finance Department should be provided for.

It would be impossible to run the administration if all powers of sanctioning expenditure were concentrated in the Finance Department. It is therefore necessary to delegate financial powers to administrative authorities and to frame rules and regulations for their proper exercise. Every public servant is under an obligation to exercise the same care and diligence in the expenditure of public money as a prudent private person might reasonably be expected to exercise in the expenditure of his own money. But this is a counsel of perfection and something more definite and workable, even though not so simple, is required for the guidance of ordinary mortals in an imperfect world. Financial codes have accordingly been issued by each Government for the guidance of its servants. Generally speaking, it may be said that there are two conditions which must be satisfied before public money can be spent —

- (1) The expenditure has been sanctioned by a general or special order of the authority competent to sanction such expenditure ; and
- (2) sufficient funds have been provided for it in the budget. These two conditions are independent of each other and it is not sufficient for only one of them to be satisfied. Both must be satisfied before any expenditure is incurred.

One of the important financial principles on which the Finance Department acts is that it is dangerous to depart from financial rules and regulations and to make exceptions in individual cases. Hard cases make bad law. Any exception to a general principle or rule is an embarrassing precedent. If A has an exception made in his favour why not B and C and D. The ultimate financial implications may be considerable and far more than was expected when the first exception was agreed to. For instance, it is a general rule that the pay of a post is fixed with reference to the responsibilities of the post. If any particular officer's work is of outstanding merit he might be promoted to a higher post when it falls vacant, but he should not be given a personal allowance or higher pay for doing his duties.

Another important function of the Finance Department in relation to expenditure is that of a co-ordinating authority. Each department knows its own work and the conditions under which it is carried on. The Finance Department also knows at what cost similar work in other departments is carried on and is in the best position to review and compare and thus obtain the best results at minimum cost. Also, there is a not unnatural tendency on the part of departments to examine financial cases entirely from their own standpoint. From their point of view they may think that they have a good case for the revision of a scale of pay, for example. The Finance Department has, however, to consider how such revision will affect comparable posts in other departments, which are sure to make a similar demand. A careful scrutiny is accordingly exercised in the Finance Department over all proposals which relate to the number or

~~gradings~~ or cadres of posts in the public service or the emoluments or other conditions of service of posts.

What is said above applies to both Central and provincial finance departments. In some big Central Departments, however, like Defence, Railways, and Posts and Telegraphs, a special system of internal financial control is in operation. Representatives of the Finance Department have been accredited to these departments and they exercise the functions of the Finance Department in greater detail, and to better effect than would otherwise have been possible. These officers assist the administration as well as watch the interests of the Finance Department.

**(b) Revenue.**—It is obviously necessary for efficient management of public finances that the Finance Department should also exercise adequate control over revenues. The degree of the control exercised varies according to differences in local conditions and circumstances in each country. In Great Britain, the administration of the main revenue departments, such as Customs, Excise, Income-tax, etc., is also vested in the Treasury, which is thus in a position to exercise adequate control over all incomings and outgoings of the public purse. In other countries arrangements are made to keep the Finance Department informed of the fluctuations in receipts, the causes of such fluctuation, and the progress of actuals as compared with the budget estimates of receipts.

Owing to the variety and magnitude of the problems involved the administration of land revenue in the provinces is entrusted to a separate authority, namely, the Revenue Department, which has its own codes and rules for the assessment, collection and remission of revenue and over the operations of which the control of the Finance Department is limited. The same remark applies to water rates, excise, stamps, registration and forests, which are the main heads of provincial revenue. But no department may, without previous consultation with the Finance Department issue any orders which involve any grant of land or assignment of revenue or concession, grant, lease or licence of mineral or forest rights or a right to water power or any easement or privilege in respect of such concession ; or any relinquishment of revenue for which credit has been taken in the budget. The Finance Department receives periodical reports of progress of the collection of revenue and is entitled to advise the departments responsible for the collection of revenue regarding the progress of collection and the methods of collection employed.

The revenue system at the Centre is organised on more or less the British system. The Central Finance Department has under its own control the Central Board of Revenue, which is responsible for the administration of the major portion of the Central revenues, such as Customs, Central Excise Duties, Taxes on Income, Salt and Opium.

**(c) Other matters.**—The Finance Department is consulted in all proposals for increase or reduction of taxation, in whatever department arising. The policy of a tax is the concern of the administrative department, but its financial implications are analysed and brought to notice by the Finance Department. The raising of public loans and the control of the public debt are also its concern. It is one of the important duties of the Finance Department to see that a minimum balance is maintained with the



Reserve Bank on account of the transactions of the Government conducted by the Bank's offices and branches. The Finance Department has also to see that adequate cash is available at treasuries the business of which is not conducted by the Bank. In order to provide adequate funds for these purposes, the Finance Department may have to arrange for taking ways and means advances from the Reserve Bank or to float treasury bills. The Finance Department is further responsible for the safe custody of all funds of the Province. The Famine Relief Fund of the province is managed by it and it sees that there is at all times an adequate balance in the Fund as prescribed by law. It is the duty of the Finance Department to prepare the budget and to arrange for its presentation to the Legislature. It has also to see that the moneys voted by the Legislature have been spent properly and to bring to the notice of the Legislature, through a Committee of the Legislature, called the Public Accounts Committee all expenditure which has not been duly authorised. The detailed procedure in regard to the preparation of the Budget is discussed in another chapter.

In addition the Finance Department of the Central Government deals with banking, mints, coinage and paper currency.

**Relation of finance to administration.**—The Finance Minister is supposed to have a big 'No' painted on his forehead. Even in private life it is extremely unpleasant to have to say no to a request made by a friend. It is far more so in public administration, when one has to do it very frequently and to colleagues who are bound to you by the closest political ties. There is, however, a certain line beyond which no Finance Department can be permitted to go. In matters of policy, the ultimate decision must be of the Government as a whole and not of any one department. The Finance Department can neither dictate nor veto policy. All that it can do is to put before the Government all the possible financial implications, the immediate cost as well as the ultimate commitment, so that Government may come to a right decision. For instance, if the Government proposes to introduce prohibition, the finance Department can only invite their attention to the diminution in revenue and increase in expenditure (in preventive staff) that it will entail. But in the last resort, in this as in every other question, considerations of public policy must prevail and the decision of the Government as a whole must be given effect to, whatever the views of the Finance Department may be.

Where no question of policy is involved, it is generally found advisable to give the Finance Department a special position of authority or primacy *vis-a-vis* the other departments of Government. In matters of detail, the opinion of the Finance Department should be allowed to prevail, even though, under the rules, it is not entitled finally to overrule another Department. There, however, arise cases on the border line, where detail ends and policy begins and in relation to such matters differences of opinion can be settled either by a discussion between the Ministers concerned or by a reference to the Cabinet.

Such a position of primacy as that contemplated above is enjoyed by the British Treasury, which can almost refuse applications from Departments without giving reasons, the onus being considered to be on the Departments themselves to justify their proposals. In India the Finance

Departments are still comparatively young and have not the long tradition of the Treasury behind them, but it is a happy sign of the times that Prime Ministers in several provinces have retained the Finance Department in their own portfolio.

**The Audit Department.**—We now come to the fourth and the last of the agencies of financial control mentioned in this chapter, namely, the Audit Department. The practical genius of the British race, which, after a protracted struggle with the Crown, hit upon the device of the responsibility of the Ministers of the Crown to Parliament and enforced this responsibility through the power of voting supply, followed it up with the independence of audit and its responsibility to Parliament. For, it was found by long experience that it was no use Parliament voting amounts for particular purposes if the Executive were free to spend the money as it liked, without Parliament knowing whether its behests were complied with or not. That the auditor should be independent of the heads of the administrative departments was conceded long ago, but that he should be independent also of the Executive Government and report to Parliament irregularities in the application of moneys voted by Parliament was not so easily conceded. The Exchequer and Audit Departments Act of 1866 embodied this principle for the first time and is one of the lasting contributions of Gladstone to the solidity of the British financial system. It has since been adopted in other countries with parliamentary systems of Government. The Government of India Act 1935 and the Audit and Accounts Order re-affirm this principle, which was established in 1913.

The Legislature votes specified amount for specified purposes. The Audit Department sees that the Executive does not spend more than the amount voted for the particular purpose and also that no money is spent for a purpose outside the scope of a vote. Breaches of the intentions of the Legislature in regard to either point are brought to notice by the Auditor General in his report on the accounts which is laid before the Legislature. In this capacity, audit acts on behalf of the Legislature.

But it also acts in another capacity, and that is on behalf of the Executive Government. Government prescribes the financial powers of its officers and lays down rules and regulations for the conduct of financial business, the maintenance of accounts, the receiving, paying and keeping of public money, etc. There obviously ought to be some agency which should see that the orders of Government are not disregarded. Audit is this agency. In this respect, audit may be said to be the eyes and ears of the Finance Department, for through it alone the Finance Department can know how things are going on.

**General observations.**—The two main principles to be observed in any system of financial control are economy and regularity, and the success of any system must depend upon the vigour with which economy and regularity are observed in day to day administration. The distinction between regularity and economy is a thing worth remembering in financial administration. By regularity is meant the spending of money for the purposes and in the manner prescribed by law. Economy, of course, means getting full value for your money. The two are not necessarily the same thing.

for it is conceivable to spend money without constitutional irregularity and yet to spend it very wastefully.

It will be seen from what has been said in this chapter that the machinery of parliamentary control of public finance—worked partly by the Legislature and partly by Audit—is intended to secure regularity only. It is designed to ensure that the Executive Government does not spend the taxes for any purpose which the Legislature does not approve, and that, for purposes which it does approve, it shall not spend more than the Legislature allows. Constitutionally, this is very important, but as a matter of business and from the point of view of the tax-payer, economy is more important. Economy is looked after by the Executive Government and more particularly by the Finance Department. It cannot be entrusted to an external authority and must be applied from within, by the very officers of the Executive Government who are responsible for the carrying on of administration, subject to the control of the Finance Department. For this reason it is necessary that a high standard of public duty should prevail in the services. There can be, and is, no better safeguard of economy.

---

## CHAPTER II.—GOVERNMENT ACCOUNTS AND THEIR AUDIT.

**Importance of public accounts.**—In Morley's *Life of Gladstone* is published a letter from Gladstone to one of his sons at school, in which he advises him to keep detailed accounts of expenditure as the only way to cultivate the habit of thrift in daily life. The same remark applies to account keeping by public bodies. In private life every prudent man keeps accounts from day to day to show how much he is getting and how much he is spending, so that he may be sure at all times that he is not running into debt. When a man is spending another person's money, as a trustee or a guardian, the keeping of accounts becomes an imperative duty. That is why Governments, which spend money collected from their people, have to be very careful about their accounts, which are published for the satisfaction of the tax-payer.

The student of public affairs, though profoundly interested in the budget, shows comparative indifference to the public accounts, which it is not easy to justify. A budget stands in the same relation to accounts as the plan of a house stands to the house actually built. A person interested in a house-plan should be even more interested in the house itself. Similarly, a person interested in public finance should be no less interested in the accounts, which alone indicate the true financial position. For instance, the budget of a particular year may anticipate a surplus. But only the accounts will show whether there was or was not a surplus during the year in question.

The importance of accounts also lies in the fact that they are the foundation of budgets and financial control. Without accounts accurate estimating would be impossible. That is seen at once when a new tax is proposed. It becomes difficult to say how much Government will receive, simply because there are no data to go upon. Again, without a knowledge of the structure of Government accounts, it is not possible to understand a budget, for the form of the budget estimate is determined by the form of the accounts. Or, take again, the point, in which everybody is interested, namely, a surplus or a deficit in a budget. That is one of pure accounting, namely, what receipts should be classed as 'revenue' and what disbursements classed as 'expenditure'. It is quite possible to manufacture a surplus budget by treating as revenue items of receipts properly classifiable under a capital or a debt head, or, what is easier still, by deciding to finance ordinary expenditure of a non-productive character from borrowed funds, instead of from revenue. So far as financial control is concerned, it will be obvious that if the Executive is to be held responsible for keeping the expenditure within the grant voted by the Legislature, they must know the actual state of affairs as disclosed by the accounts from time to time. No financial control can be exercised otherwise.

**Essentials of public accounts.**—It goes without saying that public accounts should be kept in accordance with approved principles of book-keeping, and that they should be a correct statement of facts and embrace all the financial transactions pertaining to the year. But it is no less important, if they are to evoke public interest, that they should be clear and easily understandable by the layman. They should be well arranged and in a form so as to tell the tax-payer all that he needs to know about

the Government's financial activities and the state of its purse. This is secured by classification. A mere continuous record of the transactions as they occur is not of much use even to a small trader for ascertaining how he stands in relation to his various customers or how far he is making a profit. He has to classify his transactions under various heads, as for example, the names of the various customers, the different classes of articles and the different types of business expenditure, such as advertisements, carriage, rent and taxes, etc.,. A sound system of classification thus enables the combined effect of any desired series of transactions being computed.

It is also essential that accounts should be published as soon as possible after the close of the financial year to which they relate.

To fulfil all the above requirements, namely, of scientific book-keeping, correctness, clearness and promptness in publication, is not an easy matter, as they are not always reconcilable. Sometimes to attain one you have to sacrifice the other. For instance, correctness requires that all the transactions of the year should be shown under the heads to which they really belong. But this in practice means keeping the accounts open for a long time after the expiry of the financial year and prevents promptness in publication. So, if promptness is the greater desideratum, some sacrifice of correctness is unavoidable. Similarly, in regard to others.

**The Auditor-General.**—The keeping of accounts is an executive function and is entrusted to agencies under the control of the Executive Government. The audit of accounts is a quasi-judicial function and is entrusted to an agency independent of the Executive Government. It is fundamental that the audit should be conducted by an independent person not concerned in drawing up the accounts, and that he should exercise no executive function in matters of account, such as ordering recoveries of amounts overdrawn, etc. The primary function of an auditor is to examine an account and to report upon it. In this manner all irregularities are brought to notice and the publicity which the audit report receives achieves the end in view, namely, the maintenance of orderly finance.

English practice conforms to the above theory, but in India, partly on administrative consideration and partly on grounds of economy, a slightly different system has been adopted. The keeping of accounts as well as their audit is entrusted to one and the same agency, namely, the Auditor-General of India and his staff. For this reason, the local head of the account and audit department in each province is called the 'Accountant-General' or the 'Comptroller'. He works under the control of the Auditor-General and not of the Executive Government. In the Defence and Railway Departments, however the English system prevails. The accounts are kept by a departmental agency not subject to the control of the Auditor-General, but they are audited by the Auditor-General and his staff. The accounts of the Secretary of State for India and of the High Commissioner for India are naturally kept on the English system. The Accountant-General, India Office and the Chief Accounting Officer to the High Commissioner are respectively responsible for the keeping of accounts. The audit is done by the Auditor of Indian Home Accounts.

The independence of audit is fully secured by the Government of India Act and the Government of India (Audit and Accounts) Order, 1936. Under Section 166(1) of the Act, the Auditor-General, of India is appointed by His Majesty and can only be removed from office in like manner and on the like grounds as a Judge of the Federal Court. The salary and other conditions of his service are prescribed in the Audit and Accounts Order. In order that he may have nothing to hope for from the favours of the Governor-General, it is prescribed in the Act that he shall not be eligible for further office under the Crown in India after he has ceased to hold his office. The Auditor-General has also to give an undertaking on his appointment that he will not, after he has ceased to hold his office, accept any employment in the service of a local authority, or railway company in India or of an Indian State or Ruler or save, with the previous consent of the Governor-General in his discretion, any other employment in India.

The independence secured for the Auditor-General is also extended to the officers who work under him, namely, the Accountant-General, Comptrollers and Directors of Audit, in the various provinces and departments. In relation to the performance of their audit duties no disciplinary action can be taken against them by any authority, Central or Provincial, without the concurrence of the Auditor-General.

The Auditor of Indian Home Accounts, who audits the accounts of the Secretary of State and of the High Commissioner for India, under the general superintendence of the Auditor-General, is also placed in a position of independence. Under Section 170 (1) of the Act, he is appointed by the Governor-General in his discretion and can only be removed from office in like manner and on the like grounds as a Judge of the Federal Court.

**General principles underlying Government accounts.**—In the first place, it should be noticed that Government accounts are cash accounts, that is to say, accounts of actual cash receipts and disbursements during the financial year April to March. Whatever is received or paid in cash during the year is recorded in the accounts of that year, irrespective of the fact that the receipt or payment may be in respect of previous years. In this respect India has followed the British and not the Continental model. In some European countries, such as France, rights accrued and liabilities incurred are brought to account. That is to say, every liability is brought into the accounts for the year in which it was incurred, although no payment is made for it until long after, and similarly all revenue is brought into account that ought to have been received, although it may not have been received in fact. Though, from the point of view of scientific book-keeping this is correct, it has the disadvantage that when the financial year ends, it is still quite uncertain what the realised total of the expenditure and revenue which are considered to belong to the year will be, and the nation's accounts for the year have to be kept open long after the year is over.\*

---

\*[For instance, the French accounts for 1920 were finally closed only in the beginning of 1937, whereas the Indian accounts of a year are closed by the end of October of the following year.]

For prompt closing of accounts, the cash basis system is undoubtedly superior. The cash basis system is, however, not entirely suitable for recording the transactions and presenting at any time the true state of affairs of Government commercial undertakings, such as railways, posts and telegraphs, irrigation and electric schemes, factories and workshops, etc. The main point of interest in connection with these undertakings is whether they are or are not being run at a profit and the regular accounts of Government do not enable one to see this at a glance. For this purpose, proper commercial accounts, in addition to and outside the regular accounts, are maintained for all commercial undertakings and presented to the Legislature, along with the regular accounts.

The second important point to bear in mind in relation to Government accounts is that they record the receipts and payments of the departments concerned, irrespective of the purposes for which such receipts and payments may be made. For instance, the expenditure recorded under the head 'Education' is the actual expenditure incurred by the head of the department of education and not the total expenditure on educational purposes. The expenditure on the construction of a school is an important part of educational expenditure, but it is not recorded in Government accounts under the head 'Education', but under the head 'Civil Works'. If any person were to attempt to find out the total expenditure incurred by Government on education, he would have to extract it from several heads of account. The same is true of other departments of the administration.

The accounts of commercial departments, on the other, bring out the entire revenue and expenditure appertaining to them, even though some portion of the revenue might be collected in, or some expenditure incurred on their behalf by other departments. This is necessary to ensure the correctness of the financial results of their working.

The third point is that accounting is gross and not net. That is to say, receipts are recorded on one side of the account, and expenditure on the other side. Receipts realised by a department are credited into the treasury as revenue and not used for meeting its expenses. The transactions of a revenue department, like customs or land revenue, are not shown net on the revenue side, nor of a spending department, like police, education, or the army, shown net on the expenditure side of the account. That is the general rule, but it is subject to another important rule that the public accounts should not be unduly inflated. For instance, revenue received may have to be refunded later. It would give an exaggerated idea of the true financial position, if the gross revenue received were shown on the revenue side of the account and refunds of revenue shown on the expenditure side. In such cases, refund is shown as a deduction from revenue. In the case of Railway, Posts and Telegraphs, Irrigation and Hydro-electric Departments the working expenses are shown as deductions from receipts.

**General outline of the system of Government Accounts.**—Government accounts are kept on the single entry system and not on the double entry system as in the case of commercial accounts. The double entry system, though complicated, has the advantage that each entry is controlled by a

corresponding entry elsewhere, and it will be necessary to commit two errors of the same magnitude in order to avoid showing the error in the accounts. Though Government accounts are kept mainly on the single entry system they are proved at every stage by special methods.

There are four main stages in the building up of Government accounts,

- (i) the initial accounts maintained at each treasury or in the offices of certain departmental officers where financial transactions originate ;
- (ii) the classification of the transactions, that is, the marking of each item of receipt or payment according to the head of account to which it relates ;
- (iii) the compilation by Account Officers, from the monthly accounts received from the treasuries, and from the departmental officers, of a consolidated monthly account ;
- (iv) the yearly compilation of Finance Accounts showing the annual receipts and disbursements for each province or other accounting circle, and the preparation by the Auditor-General of a general financial statement for the year incorporating a summary of the accounts of the Central Government and of all the provinces.

We now proceed to consider each of the above stages in greater detail.

(i) **Initial accounts in Treasuries.**—The unit of administration is the district, which is in charge of a Collector or Deputy Commissioner. At the headquarters of each district, there is a Government treasury in charge of a Treasury Officer, and in addition, there are usually one or more sub-treasuries located at suitable places within the district. The entire expense of the Treasury is borne by the provincial government. In places where there is an office or branch of the Reserve Bank (or a branch of the Imperial Bank of India acting as agent of the Reserve Bank), the cash balances of Government are deposited therein, and the Bank is responsible for the performance of the cash duties on behalf of Government. All Government receipts within the district, whether on account of the provincial government or on account of the Central Government, are paid into a treasury or the Bank and all payments on Government account are disbursed therefrom. A detailed account of such receipts and payments is kept by the Treasury Officer.

In the case of certain large departments, such as the Railway, Posts and Telegraphs, Public Works and Forest Departments, the receipts realised are paid into the treasury in lump and are accounted for in the Treasury merely as receipts on behalf of such departments. The detailed accounts of such receipts are kept by the Departmental Officers concerned. Similarly sums are withdrawn in lump from a Treasury or Bank by those Departmental Officers and appear in the treasury accounts merely as payments on behalf of those departments, while the detailed accounts are maintained by the departmental officers.

On the 11th of each month, a list of payments supported by vouchers is sent to the Accountant-General by the Treasury Officer for the payments



made from the 1st to the 10th of the month, and on the 1st of the succeeding month, a second list of payments with vouchers is sent, for payments from the 11th to the end of the month. The receipts and payments for the whole month are also recorded and compiled into a monthly cash account at each District Treasury and sent to the provincial Accountant-General, separate sets of accounts being rendered for transactions of the Central Government and for those of the provincial government. Similarly, in cases where lump sum receipts and payments alone appear in the Treasury accounts, the departmental Officers compile a detailed monthly account from their initial records and submit it to the Accounts Officer together with vouchers.

(ii) **Classification.**—The next step is classification, which is done in the Office of the Accountant-General, except in Madras where it is done at the Treasury. Classification is necessary not only for securing uniformity in accounting throughout the country but also to enable the preparation of budget forecasts and to watch the realisation of anticipated results. The form of the public account is the same for the Centre and the provinces. Changes in account classification are made only after consultation with the Auditor-General. It is very desirable that changes in classification be made only when absolutely necessary, as such changes make comparison with previous years very difficult.

The main divisions of Government accounts are :—

- (1) Revenue,
- (2) Capital,
- (3) Debt,
- (4) Remittance.

The above terms are somewhat technical and need some explanation.

The 'revenue' division deals with the proceeds of taxation and other receipts classed as revenue and the expenditure therefrom, the net result of which represents the surplus or deficit of the year.

The 'capital' division deals with expenditure met usually from borrowed funds or accumulated cash balances, such expenditure being incurred with the object either (a) of increasing concrete assets of a material character or (b) of reducing recurring liabilities, such as those for future pensions by payment of their capitalised value. Receipts of a capital nature are small and arise generally from sale-proceeds of concrete assets.

In some cases, capital outlay is financed from ordinary revenues instead of from borrowed funds. Such outlay, though recorded in the capital division, is taken into account in working out the surplus or deficit for the year and comes within the 'revenue' account. This point is discussed later on, in connection with the question of allocation of expenditure between capital and revenue.

The 'debt' division comprises receipts and payments in respect of which Government becomes liable to repay the moneys received or has a claim to recover the amounts paid, together with the repayments of the former and the recoveries of the latter (e.g., receipts and disbursements on

account of loans and advances, savings banks, departmental and judicial deposits, etc.).

The fourth and last division embraces transactions which fall under neither of the three divisions mentioned above, such as cash remittances from one treasury to another, remittances between England and India, receipts and payments on account of Postal, Military or Public Works Departments, etc., which, as explained already, are recorded in lump in the treasury accounts.

Within each of the four main divisions described above, the transactions are further classified under "major" heads. The major heads constitute the main units of classification and usually the transactions of each important department or line of government activity are classified under a major head, such as Land Revenue, Police, Education, Medical etc. The major heads are serially numbered, Roman numerals being employed on the receipt side and Arabic on the expenditure side. For instance, VIII Land Revenue stands for the receipt head, and 7 Land Revenue for the expenditure head.

These major heads are combined into groups called 'Sections', which have specified titles such as A. Principal Heads of Revenue, B. Railways, C. Irrigation, Navigation, Embankment and Drainage Works, etc., the Capital sections being distinguished from the corresponding Revenue sections by double letters, such as AA, BB, CC, etc.

Within each major head, there are several minor heads, which, in turn, are sub-divided into sub-heads and detailed heads which run into thousands. In this scheme, a transaction is classified with reference to the major, minor, sub and detailed head of account to which it pertains. For example,

Major head	..	..	VIII Provincial Excise.
Minor head	..	..	Hemp and other drugs.
Sub-head	..	..	Duty.
Detailed head	..	..	Ganja.

The expenditure transactions under each of the above heads of classification are further differentiated as 'Voted' or 'Charged on the Revenues' according as they are subject to the vote of the Legislature or not. This point is discussed in the chapter on the voting of the budget.

(iii) **Compilation.**—The next stage, after ensuring proper classification of transactions, is audit\* and then comes compilation of the accounts. The figures received from the various treasuries and departmental officers every month, are posted in the office of the Accountant-General and totalled so as to bring out the monthly provincial receipts and expenditure under each head. The audited monthly account is made available to the provincial government by the end of the next month. The account of a financial year has, however, to be kept open for some months after its close in order to make it a complete statement of the financial transactions pertaining to that year. The Auditor-General transmits the Finance Accounts of the year to each Government sometime in January or February of the following

\*This is dealt with separately.

year. They are then laid before the Legislature at the budget session which commences in February.

The above description applies to the accounts of provincial governments. The processes generally apply to accounts of the Central Government. The initial compilations are effected by several accounting officers, for example, the Central civil transactions taking place in provincial areas are, with a few exceptions, compiled into a monthly and yearly account by the respective provincial Accountants-General, while the Accountant-General, Posts and Telegraphs, and the Controller of Railway Accounts compile the accounts of the Postal and Railway Departments respectively. The Accountant-General, Central Revenues, books the transactions occurring in the centrally administered areas and compiles from his own accounts and from those received from other accounting officers, a consolidated account for the Central Government as a whole. The closing date of the accounts of the Central Government for any period is later than that of the provincial governments.

Finally, the Auditor-General prepares a general financial statement incorporating a summary of the accounts of the Central Government and of all the provinces, together with particulars of their balances and outstanding liabilities and containing such further information as to the financial position as may be directed by the Governor-General. This comprehensive statement is required to be submitted to the Governor-General. It takes the place of the former 'Finance and Revenue Accounts of India', which were transmitted to the Secretary of State for India for submission to Parliament.

**Allocation of expenditure between capital and revenue.**—The allocation of expenditure between capital and revenue is determined partly by considerations of finance and partly by those of accounting.

It resolves itself, really speaking, into the question, what expenditure should be met out of taxation and what out of borrowing. As is well known, the practice of governments is not uniform in the matter and writers on public finance also do not throw much light on the point.

In spite of the difficulty referred to above, there are certain accounting or commercial principles which have to be observed, particularly in relation to government commercial undertakings, such as railways, irrigation works, electric schemes, etc.

In dealing first with the point of finance in its bearing on the question of allocation, it is necessary to state that though there are no restrictions on the powers of provincial governments, it is not suggested that they do not in practice observe any restrictions in regard to the financing of expenditure from borrowed funds. Each government has its own rules, but, broadly speaking, the position may be said to be somewhat as indicated below :—

**Expenditure on a concrete asset of a material and permanent\* character, which is financially remunerative may legitimately be met out**

\*[It is necessary that the asset should not be of a temporary character and that it should belong to the authority incurring the expenditure. Grant-in-aid to a local body or institution for the purpose of construction assets cannot be regarded as capital expenditure.]

of borrowed funds and treated as 'capital outlay outside the revenue account'. In the interests of conservative finance, however, a money limit is prescribed, below which even productive outlay is met out of revenue and not out of borrowed funds. Such outlay is recorded as 'Capital outlay within the revenue account'. For the preparation of accounts according to commercial principles, it is necessary to know what the total capital outlay on a scheme is, irrespective of the source from which it is financed. That is the reason why capital expenditure, even though incurred out of revenue, is shown separately from other expenditure, also incurred out of revenue.

— It is, however, not essential that the concrete assets should be financially remunerative, in arriving at a decision whether the expenditure should be financed out of borrowed funds or not. The construction of the Capital at New Delhi out of borrowed funds is an instance in point. Though there are no restrictions on the powers of provincial governments in the matter, the principle of prudent finance once enunciated by the Government of India in the following terms is as applicable today as it was before the advent of provincial autonomy :—

“ Two conditions must be fulfilled before it would be justifiable to spend loan funds on unproductive purposes. These are, firstly that the objects for which the money is wanted are so urgent and vital that the expenditure can be neither avoided, postponed nor distributed over a series of years, and secondly that the amount is too great to be met from current revenues ”.

The fixation of a monetary limit beyond which expenditure for unproductive purposes may be incurred out of borrowed funds is within the discretion of each provincial government.

It is also permissible to treat as capital, expenditure incurred with the object of reducing recurring liabilities, such as amounts paid to Government servants in commutation of pensions. In this respect some provincial governments are more conservative than others : they prefer to meet such payments out of revenue rather than out of capital for the reason that the annual charges have become stabilised at a fairly uniform figure. Where the initial payment is made out of capital, revenue has to bear the charge on account of interest as well as an amount equivalent to the liability which would in the ordinary course have fallen on the revenue of the year.

When it has been decided that expenditure on a scheme for the creation of a new or additional asset shall be classed as capital the following are the main principles applicable to the treatment of the expenditure in the accounts :—

- (a) Capital bears all charges for the first construction of a project as well as charges for intermediate maintenance of the work : while not yet opened for service and bears also charges for such further additions and improvements as may be sanctioned under rules made by competent authority.
- (b) Subject to (c) below, revenue bears all subsequent charges for maintenance and all working expenses. These embrace all expenditure on the working and upkeep of the project and

also on such renewals and replacements and such additions, improvements or extensions as under rules made by competent authority are debitable to the Revenue Account.

- (c) In the case of works of renewal and improvement which partake both of a capital and revenue nature, it is impracticable to draw a hard and fast line between what is properly debitable to capital or to revenue. Allocation in such cases is made by detailed rules and formulæ devised by the Executive authorities, which are applied in estimates to determine the allocation of expenditure between capital and revenue. These rules and formulæ must necessarily be based upon some general principle of sound finance which should aim at an equitable distribution of burdens between present and future generations.
- (d) In theory it is legitimate to make capital bear the charges for interest on money borrowed to finance the construction of a new project before the project becomes revenue earning. In fact, however, a Government project is only part of the operations of Government and it may be sound financial administration to meet interest charges from their revenue during the process of construction. The charge of interest to capital in Government accounts is justified only when there would be undue disturbance in the Government's budgetary position by taking interest to revenue. The writing back of capitalised interest should be the first charge on any capital receipts or surplus revenues derived from a project when opened for working.
- (e) Capital receipts in so far as they relate to expenditure previously debited to capital, occurring during the process of construction of a project should be utilised in reduction of expenditure. Thereafter their treatment in the accounts may depend on circumstances, but except in the case of recovered stores on Railways and the Posts and Telegraphs Department or as otherwise provided in the rules of allocation applicable to a particular Department, they should never be credited to the ordinary revenue account of the undertaking.

**Audit.**—We have seen at what stage credit is applied to Government accounts. We now proceed to describe the processes of audit.

(i) **Audit of receipts.**—The work of revenue-collecting departments on the financial side may generally be said to fall under the following three categories :—

- (a) Assessment ;
- (b) Collection ;
- (c) Remittance of collections into the treasury.

An audit of receipts to be complete must be applied to all the above categories. In relation to (a) it is necessary to see that the assessment, or the demand against each individual, is correctly fixed and that there are no defects in methods of assessment generally. In relation to (b), audit must

see that all sums due are received and checked against demand ; that remissions and suspensions are made under proper authority, and that adequate regulations and procedure exist in relation to collection of revenue. In regard to (c), it is necessary to see that the entire collections, without any deduction or reservation, are remitted into the Treasury and brought to credit in the accounts. As regards (a) and (b) audit in India plays an extremely limited part. This task is in the main left to the revenue collecting authorities, with the exception of departments like Railways, Posts and Telegraphs, Customs and Public Works Department, whose receipts are, systematically audited by the Audit Department. As regards (c), audit obviously cannot collect the receipts given for all payments into a treasury, for these must remain with the payers as proof of their payments and to protect them against a second demand. If such receipts could be collected, audit would be in a much stronger position. These receipts would play the same part which vouchers do in relation to audit of expenditure. In these circumstances, a somewhat indirect remedy has been devised. Audit sends to all the large civil revenue-paying departments (such as land revenue, stamps, excise, etc.) monthly returns of amounts credited on their account in the treasury accounts. These they compare with their own records and the differences brought to notice are settled. The great non-civil departments (Public Works, Railways, Posts and Telegraphs, etc.) and the Forest Department send the Audit Office information as to their payments into the treasuries which it compares with the treasury credits. In this way errors or frauds on the part of the revenue or the treasury staff are prevented and corrected.

Receipts in England, whether realised by the Secretary of State for India or the High Commissioner for India, are, however, completely audited by the Auditor of Indian Home Accounts. This is in conformity with the English practice under which the Comptroller and Auditor General audits the accounts of the receipts of revenue as well as of expenditure on behalf of the House of Commons.

(ii) **Audit of expenditure.**—Audit of expenditure constitutes the main item of work in audit offices and may shortly be summarised under the following heads :—

(a) **Correct appropriation**, that is proper classification, both as to grant and head of account, and as to year of charge. The expenditure must first of all, have been actually incurred during the year and not in any previous year. Secondly, it must be classified under the proper head of account. In cases where capital and revenue accounts are kept, it is particularly necessary to see that the general principles governing allocation of expenditure between capital and revenue are not infringed. Thirdly, it must be classified under the Grant voted by the Legislature. As will be seen from the chapter on the voting of the budget, the grant and the head of account are not always the same.

(b) **Proof of payment.** There should be a voucher in support of every payment. The person to whom payment is due should have acknowledged the payment and the fact of payment should be recorded in such a manner as to make the admission of a second claim against Government

impossible. In certain cases, certificates of the officers paying the amounts are admitted in audit in place of vouchers.

(c) Application to the purposes for which the grant was intended to provide. This is an important part of the duties of an auditor. No Government servant has any authority to spend Government money for any purposes other than that included in the schedule of authorised expenditure, *vide* Sections 35 and 80 of the Government of India Act, and audit is required, under paragraph 13(1)(i) of the Audit and Accounts Order, to see that moneys disbursed from the revenues of the Centre or of the provinces, as the case may be, were legally available for, and applicable to, the service or purpose to which they have been applied or charged.

(d) A test of arithmetical accuracy. This is an obvious duty and calls for no remarks.

(e) An inquiry as to authority for expenditure. The financial powers of every public authority have been prescribed and audit has to see that no officer incurs expenditure without the sanction of the administrative authority which is competent to accord such sanction.

All financial rules and orders affecting expenditure which are issued by any authority are scrutinised by the Audit Department in order to see whether they are correct. This is obviously necessary, for if a standard of weight or measurement itself possesses any flaw, it will impart that flaw to everything it weighs or measures. It is usually found convenient to consult the Audit Officer before the issue of such rules or orders, especially in doubtful cases.

The Auditor-General, as the head of the Indian Audit Department, himself authorises considerable expenditure pertaining to the department. In pursuance of the principle that no man should be a judge in his own case, financial sanctions issued by the Auditor-General are audited by an independent officer appointed by the Governor-General. For the same reason, expenditure incurred in the office of a provincial Accountant-General is audited not by him but by another Accountant-General.

Under Section 150(1) of the Government of India Act, no burden can be imposed on the revenues of the Federation or any Province except for the purposes of India or some part of India. This is an important provision of the Act and repeats the provision in Section 20(1) of the former Government of India Act (now repealed) that the revenues of India shall be applied for the purposes of the Government of India alone. Cases have arisen in which audit had to challenge expenditure on the ground that it was not legally chargeable to Indian revenues and an audit officer is entitled to raise the question whether any expenditure is *ultra vires* under this provision of the Act.

(iii) **Audit of Stores and Stock.**—Stores and stock are cash converted into a material form and their audit is a matter of some importance, especially in departments which keep large stocks. The Indian Audit Department audits the stock accounts of a few departments only, *e.g.*, the Railways, the Public Works Department and the Telegraph Department. In England, the Comptroller and Auditor General undertakes on behalf of House of Commons an examination of the stock and store accounts

and reports to the House the results of such examination. In conformity with this practice, the Auditor of Indian Home Accounts is required to examine and audit such accounts and to report on them, in so far as stores transactions on behalf of India occur in the United Kingdom.

It is the duty of audit to see that the accounts of receipts and issues of stores are correctly maintained and that the book balances tally with the balances as indicated by the results of stock taking, which is done by an independent departmental officer and not by audit. Cases of uneconomical purchases, shortages, losses, grave defects in the system of control, etc., are also brought to notice.

(iv) **Local Fund audit.**—By law, the activities of the Auditor-General and his staff are confined to Central and Provincial receipts and disbursements. The audit of local funds is a provincial subject and provincial governments are free to arrange for such audits as they like. In some provinces, the provincial governments have their own agency for the audit of local fund accounts but in the majority of the provinces, these audits are carried out through the agency of the Auditor-General, by mutual consent.

**Relation of audit to administration.**—During the course of the scrutiny which it exercises, the Audit Department frequently comes across irregularities in the expenditure of public money. It has been given the power to effect recoveries of all amounts irregularly drawn and no authority subordinate to a provincial or Central Government, as the case may be, can overrule the Accountant-General. All financial irregularities which cannot be settled with the departments concerned are reported by the Accountant-General to Government both in the administrative as well as the finance departments. Important cases are included in the report on the Appropriation Accounts for the information of the Legislature.

The question frequently asked is—and a very legitimate question too it is from the point of view of the lay man and the tax-payer—whether audit rules and regulations serve any practical purpose, that is to say, whether they conduce to economy in the spending of public money. It has been mentioned before that audit concerns itself with regularity and not with economy. No spring can rise higher than its source and it would be just as correct to accuse audit of inability to check extravagance in expenditure as it would be to accuse a judicial officer of inability to prevent breaches of the peace. Audit only sees that financial rules and orders are strictly observed and that public departments do not incur expenditure contrary to the expressed intentions of the Executive Government or the Legislature. Beyond that it does not and cannot go. Economy, in most cases, is dependent on knowledge of facts and the Audit Department is not in direct touch with facts. If an engineer of the Public Works Department includes in his account a charge for 500 coolies employed on the construction of a work, audit has no means of knowing whether they were all actually employed or not on the work in question. Though audit occasionally brings to the notice of the administrative officers instances of extravagance or waste, it remains still true that the duty of seeing that economy in expenditure is being observed rests primarily with the administrative officer and secondarily with the Finance Department.



Another question frequently asked is—Does audit pay its expenses ; or, in other words, do audit officers detect irregularities or recover over-payments large enough to justify the money spent on them ? The same question may be asked in relation to the police department and the recovery of stolen property. But that is not the proper way to look at things. The true value of audit is not to be gauged by the irregularities which it actually discovers, but by the certain effect of the knowledge that the auditor will without fear or favour, report them if they come to his notice. That knowledge constitutes in itself the most effective security against irregularity, and explains why financial irregularities are not more numerous than they are today.

### CHAPTER III—THE PREPARATION OF THE BUDGET.

**Meaning of the word 'budget'.—**The word 'budget' is derived from the French *bougette*, a diminutive of the old French *bouge*, meaning a small leather bag or wallet. In its present sense the word was first used in 1733 in connection with Walpole's financial scheme in a satire entitled 'The Budget Opened'. Walpole was represented in this pamphlet as a conjuror, the budget being his wallet or bag of tricks. To this day, English newspapers publish photographs, on Budget Day, of the Chancellor of the Exchequer with an attache case in his hand containing his financial proposals, while going to the House of Commons to make his Budget speech. 'Opening the budget' is now the accepted Parliamentary Phraseology.

The meaning of the word 'budget' has shifted from the bag to the documents which the bag contains, that is, to the financial proposals which the Chancellor of the Exchequer puts before Parliament every year. In Section 33 and 78 of the Government of India Act, 1935, reference is made to the submission of an "Annual Financial Statement" before the Legislature. This document is a 'statement of the estimated receipts and expenditure for the financial year' and is generally known as the Budget.

**Importance of the budget.**—The budgetary system, as we know it to day, is British in origin and has been adopted by other countries. As in private life and in business concerns it is not customary to have a budget for a whole year, it is necessary to understand why a Government should have a budget at all. One thinks in this connection of the lady in Punch, who said :—

"Of course I'm only a woman, but I don't see what good it does the country having a budget. It only means worrying before you spend the money instead of after".

Students of English constitutional history know that the struggle for representative government in England began with the right to control the purse. When this was acquired, the right to control expenditure through appropriation was asserted, and still later, the Executive were required to produce for the approval of Parliament every year a complete plan of income and expenditure which we now call the budget. To this approved plan the Executive were required to adhere and steps were taken to see that they did so. What happened in England happened more or less in other European countries and the British Dominions. Those who carried on the struggle for responsible government found that popular control of finance was essential and that there was no better way of asserting that control than to require the Government to submit a comprehensive plan for the approval of the Legislature showing how much money they needed for any one year and how they proposed to spend it.

The budget is the starting point of financial control by the executive as well as by the Legislature. It is more than that : it is the basis of orderly finance, without which there can be no lasting social progress. It defines the objects on which public money may legally be spent and it prescribes limits for the expenditure of money on specific objects which may not be exceeded.

Apart from financial control, the main object in preparing a budget is the enforcement of economy. It is only when expenditure is considered in relation to revenue that the necessity for economy becomes manifest. Every department of Government has several schemes of expenditure which are very necessary and desirable in themselves. If the money required could be found, perhaps they would all be taken up in any one year. But the funds available are usually not sufficient to meet them all and a great many of them are rejected every year because of the necessity to balance the budget, or, in other words, to keep expenditure within income. This process of balancing also helps in establishing an order of priority among the various items of new expenditure, and schemes are selected not merely to suit the exigencies of the moment or the importunities of an enthusiastic head of a department, but on a careful review of their relative urgency and importance and after paying due regard to the requirements of the administration as a whole.

The balancing of the budget is the first requisite of financial stability, and occupies the same place in financial administration as the maintenance of law and order in the executive administration. One or two deficit budgets in succession may not perhaps matter, and may be condoned if due to exceptional circumstances, but a government which habitually budgeted for more expenditure than the revenue at its disposal would soon suffer in financial credit. Unbalanced budgets are bound sooner or later to weaken the faith of investors and to lead to monetary inflation, which, if uncontrolled, will terminate in national disaster.

**General Rules.**—The budget is prepared on the basis of what is expected to be actually received or paid (under proper sanction) during the year, including arrears of past years, not for liabilities incurred within the year but not due for payment in that year. In other words, the budget is an estimate of cash receipts and cash payments during the coming year, irrespective of the fact that such receipts and payments relate to the transactions of that year or previous years. For instance, material to be ordered in March 1939 but not expected to be paid for till April 1939 will be provided for in the budget for the year 1939-40 and not in the budget for the year 1938-39. Similarly, revenue though due in March 1939, but not expected to be received in the treasury till April 1939 will be provided for in the receipt estimates of the year 1939-40 and not 1938-39.

Another important rule is that budgeting should be on a gross and not a net basis. The gross transactions in the case of both receipts and charges in each department should be entered separately. Receipts are to be estimated as receipts on the receipt side of the budget and expenditure on the expenditure side, or in other words, it is not permissible to deduct receipts from charges or charges from receipts and frame the budget for net receipts (in the case of revenue departments) or net charges (in the case of spending departments). The Legislature loses its control over expenditure if the Executive has considerable receipts available for meeting expenditure and comes to the Legislature for authority merely for that part of the expenditure which it cannot meet from such receipts. In certain cases, budgeting is on a net basis. For instance, refunds of revenue are deducted from the gross collections and the budget is prepared only

for the net receipts. The reason is that refunds do not really represent the expenditure of Government but are merely repayments made out of the receipts.

The practice in India on this point is somewhat different from that in the United Kingdom where a system of what is known as 'appropriation-in-aid' is followed. Under this system receipts in the main spending departments, such as Army, Navy, Air Force, etc., are classified as deduction from expenditure and are not shown in the receipt estimates.

All budgets are prepared on an annual basis. A year seems to be the maximum of time for which legislatures can afford to give financial power to the Executive and the minimum of time which the Executive needs to put the budget into execution.

As the Legislature grants funds to the Executive on a yearly basis, it follows that no money can be spent for any year unless it is authorised in the sanctioned estimates *for that year*, irrespective of the fact that such sanction may have been accorded by the Legislature for the previous year. In other words, all appropriations expire at the close of the financial year, and no portion unexpected during the year may be reserved or appropriated by transfer to deposits or any other head, or drawn and kept in the cash chest to obviate the lapsing of the grant and to be expended after the end of the year for which the grant was made. This is known as the '*rule of lapse*'. It is obvious that financial control would become impossible if spending departments were permitted to spend in any year unutilised savings of previous years in addition to the grants placed at their disposal for that particular year. At the same time it must be recognised that this '*rule of lapse*' prevents planning of expenditure over a long period which is sometimes necessary for big schemes, for no Legislature can or will be committed to voting funds in advance. It also sometimes leads to what is known as '*the rush of expenditure in March*'. Officers in their eagerness to spend the money allotted to them sometimes authorise expenditure which they would not have done if they were permitted to utilise the savings in the succeeding financial year.

To mitigate the undesirable consequences of the rule of lapse several funds have been built up at the Centre and in the provinces in recent years, such as the Defence Reserve Fund, the Road Development Fund, the Civil Aviation Fund, the Fund for economic development and improvement of rural areas, etc. Unspent balances in these funds do not lapse at the end of the year, but are available for expenditure in succeeding years.

Another important rule is that the budget should include all revenue and *all* expenditure of the government. It is not correct to prepare extraordinary budgets for special purposes (as is done in some European countries) or to have separate budgets for administrative departments. Such devices obscure the true financial position and make it difficult to assess the real surplus or deficit of the Government as a whole. In relation to railways, however, separate budgets are considered correct in principle and the practice of various countries, such as France, Germany and

Switzerland, which have State railways, is in favour of separation. The main grounds in favour of separation of the railway budget are —

- (i) that railway policy and railway administration should be free from political influence, and
- (ii) that railways, after they have made their contribution to the State, should be free to devote their surplus profits to railway development.

In India for several years the railway budget has been separated from the general budget of the Central Government. The Crown budget, that is to say, the budget of the Representative of the Crown in the exercise of functions relating to Indian States, also does not form part of the Central budget, though it is financed from Central revenues. In the provinces there is no exception to the general rule and there is only one budget for the entire financial transactions of each provincial Government.

Again, it is essential that the form of the estimates should correspond to that of the national accounts. This will be easily understood. If the estimates were prepared in a form different from that of the accounts, financial control would become impossible. There would be no uniformity as between province and province and comparison of results achieved would become extremely difficult. Under the new Constitution, governments in India, at the Centre and in the Provinces have considerable latitude in regard to the form in which they prepare their estimates. The form of the accounts is prescribed by the Auditor-General with the concurrence of the Governor-General. It is usual for the Executive Government to consult the Auditor-General before making any important change in the form of the estimates. Up to now the form of the budgets has been more or less uniform throughout the country. It is greatly to be hoped that this feature will not be disturbed in future.

Last, but not least, it is most necessary that estimating should be close. While provision should be made for all the items that can be foreseen, it is essential that the amount of the provision should be restricted to the absolute minimum necessary. The general tendency among estimating officers is to under-estimate the revenue and over-estimate the expenditure. To a certain extent, this tendency is natural, as it is safer to have a margin of possible error than to have none at all. It is obvious that over-estimating of revenue and under-estimating of expenditure would be by far the greater evil of the two. In a country like India, it is dangerous finance not to be conservative, as it is so difficult to devise and levy new taxes to meet a deficit, and as the revenue is liable to sudden diminution from climatic and economic causes. It is no less difficult besides being wasteful to effect retrenchment if expenditure is increased to equal unduly over-optimistic forecasts of revenue. The absolute approximation of estimates to actuals is impossible and a small margin of variation, both for savings and excesses, is usually allowed. It is only when this margin is exceeded that the Public Accounts Committee demands an explanation. The insistence on close budgeting is based on two considerations. The legislature is naturally interested to see that more money is not taken from the tax-payer than is absolutely necessary for

the requirements of the public service, and it is obvious that this would be the case if there were habitual and serious under-estimating or revenue and over-estimating of expenditure. Secondly, the Finance Department, is also interested to see that the administrative departments do not obtain more money than they really need. For, if a department is allotted funds which it will not be able to spend, it prevents others from getting grants for urgent or useful schemes or secures for itself a march over other departments in pushing through new schemes for which it can say it has got the money, but which on their merits alone might possibly have been turned down.

**Preparation of the budget.**—The detailed procedure may vary from province to province but the main outlines are as follows. The estimates are prepared in August or September by the district officers and sent to heads of departments in two parts :—

Part I relating to revenue from existing sources and to standing charges.

Part II relating to new schemes of expenditure and proposals for abandonment of existing sources of revenue, otherwise than in pursuance of rules or orders.

Part I of the estimates is prepared on skeleton printed forms supplied by the Finance Department in the month of July. The estimate of revenue is separate from the estimate of expenditure, even though both the revenue and the expenditure may be under the control of the same officer. The following is a typical skeleton form for a detailed estimate of expenditure for 1939-40.

Minor heads and Sub-heads of appropriation.	Accounts, 1937-38.		Budget Estimate, 1938-39.		Revised Estimate, 1938-39.		Budget Estimate, 1939-40.		Accounts, months.				Remarks.	
									1937-78.		1938-39.			
	Non-Voted.	Voted.	Charged.	Voted.	Charged.	Voted.	Charged.	Voted.	Charged.	Voted.	Charged.	Voted.		
1	2	3	4	5	6	7	8	9	10	11	12	13	14	

[The expression 'charged' used above means Non-voted.]

The form used for a revenue head is the same as for an expenditure head, except that there are no separate columns for 'voted' and 'charged' as no votes are taken on receipt estimates.

As will be seen from the specimen given, each form contains columns for :—

- (i) actuals of the previous year,
- (ii) sanctioned estimate for the current year,
- (iii) revised estimate for the current year,
- (iv) budget estimate of the next year, and
- (v) actuals of the current year available at the time of preparation of the estimates and actuals for the corresponding period of the previous year.

All the columns are filled in by the district officer with the exception of the column relating to the sanctioned estimate of the current year which is printed in the skeleton form supplied by the Finance Department. The principal columns are those relating to the revised estimate of the current year and the budget estimate of the next year. Of these the making of the revised estimate always precedes the making of the budget estimate of the future year, as it is an axiom of budget procedure that, *prima facie*, the revised estimate is the best guide for the framing of the coming year's estimate.

The revised estimate is an estimate of the probable revenue and expenditure of the current financial year framed during the course of the year on the basis of the actual transactions up to the time of its preparation and anticipations for the rest of the year in the light of orders already issued or contemplated or any other relevant facts. It is a financial estimate prepared for the information of the Executive Government showing how much they expect to receive or spend under any particular head. The revised estimate does not authorise any expenditure, nor does it supersede the budget estimate as the basis for the regulation of expenditure. For instance, if the budget grant for police is Rs. 40 lakhs, and the figure accepted by the Finance Department for the revised estimate is Rs. 45 lakhs, it does not mean that the Inspector-General of Police is authorised to incur expenditure up to Rs. 45 lakhs. Nor if a lower figure is adopted in the revised estimate, does it mean that the grant of the department is correspondingly reduced. The acceptance of a higher or lower figure in the revised estimate means nothing more than this that Government, on the basis of the latest information available, anticipate that the expenditure of the department in question will be greater or less than that sanctioned in the Budget. If the expenditure anticipated is greater, the department concerned must take necessary steps without delay to obtain a supplementary grant. If the expenditure anticipated in the revised estimate is less the department must surrender the saving in good time before the close of the year to the Finance Department.

After the preparation of the revised estimate of the current year, is undertaken the preparation of the budget estimate of the next year. The task of framing the budget estimate is one requiring sound judgment and experience. It is not a simple arithmetical exercise in striking out averages of previous years' actuals and putting in a safe figure which would not look exactly like a repetition of the last year's performance. Behind figures lie the insistent realities of administration. The circumstances of no one year are exactly similar to those of the previous year and yet they are not quite dissimilar. One has, therefore, to use his judgment in estimating the similarities and dissimilarities and making due allowance for each.

Estimates of revenue are framed on the assumption that agricultural and economic conditions during the year in question will be of a normal character. This is the only possible basis on which to proceed, as the estimates are framed at a time when nothing is known about monsoon conditions in the coming year. As regards expenditure the material available is more definite. Provision is made for all sanctioned schemes, but not for scheme of new expenditure which have been submitted to the Government, but not yet sanctioned. And even in relation to sanctioned schemes, provision is made only for such amount as will actually be required for expenditure during the coming year, and not necessarily for the full amount of the sanction.

Brief explanations are furnished in column (14) 'Remarks' of material variations between the revised and budget estimates of the current year and between the revised estimates of the current year and the budget estimates of the coming year.

New schemes come in Part II of the estimates. Every Part II scheme is accompanied by an estimate of the loss of revenue or additional expenditure involved, with a detailed statement of the grounds in support of it. Information is also given as to the ultimate cost of each scheme as well as the cost in the budget year, both recurring and non-recurring.

The estimates as received from the district officers are consolidated for the whole of the department by the departmental head. In addition to consolidation, the head of the department reviews and revises, where necessary, the figures of the local officers in the light of his wider experience and more extensive information. The estimates of revenue and Part I expenditure are submitted by the heads of departments to Government on prescribed dates between the months of September and November. One copy of the estimates is sent to the Administrative Department of the Secretariat and another to the Finance Department. The Administrative Department examines the revenue and expenditure estimates, and suggests alterations, where necessary, to the Finance Department. The Finance Department subjects the estimates to a thorough scrutiny, and after considering the remarks of the Administrative Department passes orders on the departmental estimates.

We have next to see what scrutiny is applied to Part II of the estimates. This part consists of schemes which have already been sanctioned



by the Government, subject to provision of funds in the ensuing year and schemes which have yet to be examined. It includes schemes involving abandonment of revenue. Heads of Departments send their proposals to Government in the Administrative Department by certain prescribed dates. The Administrative Department scrutinises each scheme and forwards it to the Finance Department with its detailed remarks and recommendations. The scrutiny applied by the Finance Department is different in character to that applied by the Administrative Department. For the policy of the expenditure or its necessity or urgency the Administrative Department is responsible. The Finance Department is mainly concerned with economy. Its duty is to analyse each scheme, and assess properly its financial implications, bringing out clearly the immediate cost as well as the ultimate commitment, recurring as well as non-recurring. Differences of opinion between the Administrative Department and the Finance Department are submitted to Government for decision.

The heads of departments are concerned only with the preparation of the revenue and expenditure estimates. In addition there are estimates under debt, deposit and remittance heads, which are of no less importance. The Finance Department has to assure itself that there will be sufficient cash throughout the coming year not only for the expenditure of the various services and departments of the public administration, but also for the other transactions mentioned above, which form part neither of the revenue of the government nor of its expenditure. Special importance attaches to the estimates of permanent and temporary loans, which are framed after a careful review of the cash position under all the heads for the coming year. The estimates under these heads are generally prepared by the Accountant-General and are submitted to the Finance Department, which passes final orders thereon. The Accountant-General, in some provinces, is also required to scrutinise the departmental estimates with a view to seeing whether the figures in the expenditure estimates are correct on the basis of existing sanctions and whether the revised estimate is justified or not. In other provinces, this work is done in the Finance Department and the assistance which the Accountant-General renders is confined to the furnishing of actuals from his books and to preparation of estimates under certain heads, like pensions, interest on debt, etc., for which details are available in his office alone.

The Finance Department now prepares the first edition of the Budget Estimates for submission to the Cabinet. Questions of policy arising from the budget, such as fresh taxation or allocation of surplus or provision of new services which mean an extension of the activities of public departments, etc., are considered and decided upon by Government as a whole. After such decisions are taken, the annual financial statement and demands for grants are prepared for presentation to the Legislature. A description of these documents is given in the next chapter.

The procedure for the preparation of Central estimates and the estimates of the Crown Representative's Department is essentially the same

as for provincial estimates. The estimates are prepared by the administrative officers concerned and are compiled as follows :—

- (i) Estimates relating to civil departments by provincial Accountants-General and the Accountant-General, Central Revenues.
  - (ii) Estimates of the Defence Services by the Financial Adviser, Military Finance.
  - (iii) Estimates of the Railway Department by the Financial Commissioner for Railways.
  - (iv) Estimates of the Communications Department including Postal and Telegraph Services by the Finance Officer, Communications.
-

## CHAPTER IV.—THE VOTING OF THE BUDGET.

The budget, after having been passed by the Executive Government, is presented to the Legislature towards the end of February or beginning of March. The date of presentation is usually arranged in such a manner that the voting of the demands for grants as well as the passing of the taxation bills may be completed before the commencement of the next financial year.

The budget goes through three stages before it is passed :—

- (i) Presentation to the Legislature ;
- (ii) Discussion and voting in the Legislature ; and
- (iii) Authorisation by the Governor-General or the Governor, as the case may be.

**Presentation of the budget.**—A statement of estimated receipts and expenditure in respect of every financial year has, under the Government of India Act, to be laid before the Legislature. This statement is known as the ' Annual Financial Statement ' or ' Budget '. The surplus or deficit anticipated during the year has to be worked out and non-votable expenditure has to be shown separately from votable expenditure. If there is any expenditure, within the votable section, which has been included in the estimates as being necessary for the due discharge of any of the special responsibilities of the Governor, it has to be separately indicated. This is necessary for two reasons. Firstly, it is only fair to the Ministry that the Legislature should know that the provision has been made on the responsibility of the Governor and not of the Ministers. Secondly, if such items are not indicated at the time of the presentation of the estimates, restoration would not be possible, should the Legislature cut down or omit any such item.

On introducing the budget, the Finance Minister makes a speech in the Legislative Assembly. In the other Chamber, where it exists, the budget is presented either simultaneously or later, by the Finance Minister or somebody else on his behalf. Budget speeches everywhere follow a classical pattern and only occasionally betray the touch of a human hand. First of all are given the final accounts of the year which ended eleven months earlier, then a revised forecast of the outturn of the year which has still a month or two to run, and after that the forecast of the coming financial year. Important variations between the budget figures and the actuals of the past, and between the budget figures and the revised estimates of the current year are explained. If the current year is expected to close with a surplus larger than that provided for in the Budget, proposals for its allocation are given. Similarly in the case of a deficit, an explanation is given as to how it will be met. As regards the coming year, more detail is given. The revenue and expenditure estimates are analysed in some detail, and particularly the proposals for new expenditure on the nation-building services. If on the basis of existing taxation there is a deficit, proposals for fresh taxation are submitted. Then comes the programme of capital expenditure, such as on electric, irrigation and other schemes, and proposals for financing it, such as by raising a public loan, etc.

**Demands for Grants.**—A copy of the printed speech is supplied to every member of the Legislature together with several statements explaining the figures. The most important compilation is the book called 'Demands for Grants' for the coming financial year. Each demand contains, first, a statement of the total amount required, then, details by sub-heads, and lastly, a detailed estimate under which each sub-head is divided into items. New items of expenditure are shown in a distinctive manner to assist the members in gauging their financial effect. Votable and non-votable items in each demand are shown separately, the non-votable items being generally printed in italics. In Great Britain, non-votable items are omitted from the estimates presented to the House of Commons. In India, the Legislature gets a complete picture of the financial position, even though it is not required to vote on several items of expenditure.

Each Government has perfect freedom to include whatever items of expenditure it likes in any one demand. It is not necessary to follow the heads of account, but in practice a demand is *ordinarily* proposed for each major head of account. It is, however, not always found convenient to have a demand for grant in respect of each major head. In certain cases more than one demand is presented for one major head, while, in others, a single demand includes more than one major head. At the centre, it is found convenient to submit one demand for an entire area, such as Ajmer-Merwara or Delhi. With the exception of these administered areas, the rule is that a separate demand is made in respect of each department.

**The Estimates in the Legislature.**—The procedure for the discussion and voting of the estimates in the Legislature is contained in the Legislative Rules, which are framed with the approval of the Legislature. Each Chamber has its own set of rules and details may therefore vary from province to province, but, generally speaking, the procedure is briefly as follows :—

There is no discussion of the budget on the day on which it is presented to the Legislature. After its presentation, the budget is dealt with in two stages, namely :—

(i) A general discussion ; and

(ii) The voting of demands for grants.

**The general discussion of the budget.**—A few days after the presentation of the budget begins the general discussion in either Chamber of the budget as a whole or any question of principle involved therein. This discussion usually lasts two to three days. No motion can be moved at this stage nor can the budget be submitted to the vote.

Barring certain items, such as salaries and allowances of the Governor-General and Governors and expenditure relating to their respective offices, and the sums payable from Central revenues on account of the expenses of the Crown Representative and his department, members are at liberty to bring up any topic during the general discussion, which has any bearing

on the estimates presented to the House. This general discussion is supposed to serve three purposes. It enables the members of the Legislature:—

- (i) to discuss revenue estimates ;
- (ii) to discuss non-votable expenditure ; and
- (iii) to discuss the ways and means programme of Government.

The speeches made at this stage also enable the Government to feel the pulse of the House and judge as to how their budget proposals may be dealt with in subsequent stages. Otherwise, the discussion is of an academic character and is marked by a sense of unreality and produces few serious contributions to budgetary finance. The debate is wound up by the Finance Minister who has a general right of reply at the end of the discussion.

**The voting of grants.**—After the general discussion is over, the second stage commences, namely, the voting of grants. This has reference only to votable items. So far as non-votable items are concerned, the Legislature has finished with them at the general discussion stage. In the provinces, the Legislative Assembly alone is competent to deal with the budget at this stage. The Legislative Council has nothing to do with the voting of the demands for grants. In the transitional Centre, the lower House alone is entitled to vote, the Council of State having no further say in the estimates beyond the general discussion. When Federation is established, both the Houses will be equally entitled to vote the demands for grants, but the lower House will occupy a special position. The demands for grants will first be submitted to the Federal Assembly and thereafter to the Council of State. Where the Assembly have refused to assent to any demand, that demand cannot be submitted to the Council of State, unless the Governor-General so directs. Where the Assembly have assented to a demand subject to a reduction of the amount specified therein, a demand for the reduced amount only can be submitted to the Council of State, unless the Governor-General otherwise directs. In either of these cases, the demand submitted to the Council of State cannot be for a greater amount than that originally demanded. Where the Chambers differ with respect to any demand, the matter will be decided in a joint sitting by the vote of the majority of the members of both the Chambers.

Under the Act, demands for grants have to be submitted in respect of all expenditure which is not charged on the revenues of the province (or the Centre). Neither the Act nor the Legislative Rules give any definition of the term 'expenditure', but as a matter of practice it has been held that it covers:—

- (1) what is technically called 'expenditure' in the public accounts, including capital expenditure incurred from borrowed funds.
- (2) certain disbursements under the debt head 'Loans and Advances', but not under other debt heads.

It is not held to cover disbursements under deposit and remittance heads.

No votes are taken for receipt estimates. The taxation proposals of the Government are dealt with on the Finance Bill or on separate Bills,

but the Legislature does not go into the figures under revenue heads, or alter them on the ground that the estimates are not accurate. A proper estimate of the receipts is left entirely to the Executive Government.

**Procedure for the voting of grants.**—Each demand is introduced by the Minister-in-Charge of the subject and is in the following form :—

“ That a sum not exceeding Rs. \_\_\_\_\_ be granted to the Governor (or Governor-General) to defray the charge which will come in course of payment during the year ending 31st March 19\_\_\_\_, in respect of \_\_\_\_\_ (here the subject of demand is stated) ”

In submitting the demand, the speech made by the Minister is largely political, very seldom financial. It is a review of the work done by his department during the year and a statement of what he proposes to do during the coming year. The speeches of other members are also of the same character.

A fixed number of days is allotted for the voting of grants. For the discussion of any one demand a maximum limit of time is fixed, and as soon as this limit is reached, the Speaker of the House is, under the rules, required to put forthwith every question necessary to dispose of the demand under discussion. Similarly, if the last day of the days allotted for voting of grants is reached and the discussion is not finished by 5 p.m., the Speaker is required to put forthwith every question necessary to dispose of all the outstanding matters in connection with the demands for grants. This is known in parliamentary language as ‘ the guillotine ’. Under the operation of the guillotine several demands are passed every year without any discussion, in the provinces as well as at the Centre. However much one may regret it as detracting from parliamentary control of public finance, it is inevitable so long as the number of days allotted to supply is not considerably increased and the number of cut motions on the demands very largely reduced.\* A similar state of affairs exists in England, as will appear from the following extract from Hilton Young’s System of National Finance, 3rd Edition, page 53 :—

“ Between a third and a half of the total expenditure for the year is often voted in an hour or so, without any sort or kind of debate or criticism; A more unsatisfactory state of affairs could hardly be imagined. It reduces the whole laborious process of the control of expenditure by the House to something of a farce.”

The time allotted to Supply in India is about 8 or 10 days as against 20 in Great Britain. This is partly due to the fact that the budget has to be passed before the next year commences and presentation cannot begin much before the end of February.

In accordance with English Parliamentary practice, the Government of India Act prescribes that demands for grants must emanate from the

\* [For instance, in Madras about 2000 cut motions were tabled in connection with the demands for the year 1936-37, and over 1000 in Bengal for the budget of 1937-38.]

**Executive Government and not from private members.** Such a provision is necessary as a safeguard against improvident expenditure or expenditure for which the Executive Government is not prepared to take responsibility. It also protects the private member from importunate demands from his constituents, for expenditure on subjects in which they are particularly interested, but which may not be necessary in the interests of the country as a whole.

Further, the Act provides that when a demand is made, the Legislature may refuse assent to it or reduce it, but may not increase it. Nor may it alter its destination, or annex any condition, as that would be tantamount to proposing a new grant. In cases where the Legislature is of opinion that expenditure on a particular item should be incurred or increased (if the item is already in the estimates), it may pass a resolution making that recommendation to the Governor (or the Governor-General) and if the resolution is accepted that particular expenditure would be considered for inclusion in the estimates in due course. Such recommendatory resolutions are, however, no part of the budget discussion and have to be moved on separate days allotted for the purpose. The position in India in regard to this matter is exactly the same as in Great Britain and the self-governing Dominions.

**Non-votable expenditure.**—Items charged on the revenues are non-votable items. That is all. Charged items enjoy no priority over voted items in respect of disbursement; that is to say, they do not constitute a 'first charge' on the public revenues. Under Section 78(3) of the Act, the following expenditure is charged on the revenues of each Province and is non-votable. —

- (a) the salary and allowances of the Governor and other expenditure relating to his office for which provision is required to be made by Order in Council;
- (b) debt charges for which the Province is liable, including interest, sinking fund charges and redemption charges, and other expenditure relating to the raising of loans and the service and redemption of debt;
- (c) the salaries and allowances of ministers, and of the Advocate-General;
- (d) expenditure in respect of the salaries and allowances of judges of any High Court;
- (e) expenditure connected with the administration of any areas which are for the time being excluded areas;
- (f) any sums required to satisfy any judgement, decree or award of any court or arbitral tribunal;
- (g) any other expenditure declared by this Act or any Act of the Provincial Legislature to be so charged.

There is the following provision in Section 33(3) for the Federation :—

- (a) The salary and allowances of the Governor-General and other expenditure relating to his office for which provision is required to be made by Order in Council ;
- (b) debt charges for which the Federation is liable including interest, sinking fund charges and redemption charges, and other expenditure relating to the raising of loans and the service and redemption of debt ;
- (c) the salaries and allowances of ministers, of counsellors, of the financial adviser, of the advocate-general, of chief commissioners, and of the staff of the financial adviser ;
- (d) the salaries, allowances, and pensions payable to or in respect of judges of the Federal Court, and the pensions payable to or in respect of judges of any High Court ;
- (e) expenditure for the purpose of the discharge by the Governor-General of his functions with respect to defence and ecclesiastical affairs, his functions with respect to external affairs in so far as he is by or under this Act required in the exercise thereof to act in his discretion, his functions in or in relation to tribal areas, and his functions in relation to the administration of any territory in the direction and control of which he is under this Act required to act in his discretion : provided that the sum so charged in any year in respect of expenditure on ecclesiastical affairs shall not exceed forty-two lakhs of rupees, exclusive of pension charges ;
- (f) the sums payable to His Majesty under this Act out of the revenues of the Federation in respect of the expenses incurred in discharging the functions of the Crown in its relations with Indian States ;
- (g) any grants for purposes connected with the administration of any areas in a Province which are for the time being excluded areas ;
- (h) any sums required to satisfy any judgement, decree or award of any court or arbitral tribunal ;
- (i) any other expenditure declared by this Act or any Act of the Federal Legislature to be so charged.

The question whether any proposed expenditure falls within a class of expenditure charged on the revenues of a province or the Federation is decided by the Governor or the Governor-General, as the case may be, in his discretion. Generally speaking, about 17 per cent. of provincial expenditure is non-votable. At the Centre, excluding Railways, voted expenditure is about 27 per cent. of the total. In the Railway Department, whose gross expenditure is greater than that of all other Central Departments put together, voted expenditure is 72 per cent. of the total



**Motions on the voting of grants.**—It has been stated above that it is within the competence of the Legislature to move motions for reduction of grants. Such motions are made with two objects :—

One is to effect economy.

The other is to obtain satisfaction or elicit information from Government on a particular point arising from the estimates.

In the first case, a motion specifying the amount which it is intended to reduce is made. Now it is obvious that a member can justify his proposal for reduction only if he states definitely on what item or items included in the demand in question the reduction proposed by him should be made and gives good grounds for making that proposal. But whether he can formally table a motion specifying the amount which he proposes to reduce *on a particular item or items* has not yet been authoritatively decided. Practice in the matter is not uniform : in some provinces such motions are permitted ; in others motions for reduction only in the total amount of a demand for grant and not on a particular item or items composing it are allowed.

More usually, the motions are of the second class, that is to say, their object is to obtain satisfaction or information on particular points. In such a case a motion for reduction of a nominal amount, say Rs. 100, is made, which is pressed to a division if the Government reply is considered unsatisfactory and may, in some cases, amount to a motion of censure. This is in accordance with the practice of the British House of Commons where such motions in the Committee of Supply are very common.

Cut motions on demands seldom raise points of economy ; they are meant to raise political issues. For instance, cut motions under the land revenue demand generally raise questions relating to the necessity for an appreciable reduction in assessment or scaling down of agricultural debts. Similarly, on cut motions on the excise demand are discussed excise policy and questions like prohibition, etc., and so on. Similarly, at the Centre all the major heads of governmental activity come under the searchlight of criticism on cut motions. Reductions of specific amounts with a view to economy are very rare indeed.

Movers of cut motions are required to indicate what subject they will raise for discussion, so that the Treasury benches may be prepared for it and may be able to announce the policy of Government on the point raised.

**The Schedule of authenticated expenditure.**—After the voting on the demands is over, the Governor or the Governor-General (as the case may be), is required by the Government of India Act to authenticate by his signature a Schedule specifying—

- (a) the grants made by the Assembly (in the case of a province) or by both the Chambers, (in the case of the Federation) ;
- (b) the several sums required to meet the expenditure charged on the revenues of the province (or of the Federation) but not exceeding, in the case of any sum, the sum shown in

the budget originally laid before the Legislature. Where the Legislature has rejected or reduced any demand which relates to the special responsibilities of the Governor (or the Governor-General), the latter is empowered by the Act to restore the rejected or reduced demand, if he considers it necessary in order to enable him to discharge his special responsibilities.

The schedule so authenticated is then laid before the Legislature, but is not open to discussion or vote in the Legislature. It takes the place of the Annual Appropriation Act in England and under the law no expenditure from the revenues of a province (or the Federation) can be deemed to be duly authorised unless it is specified in this schedule.

**Supplementary demands.**—If during the course of the year further expenditure becomes necessary over and above the expenditure authorised for that year, a supplementary statement has to be presented to the Legislature, showing the estimated amount of that expenditure in exactly the same detail as for the original budget statement. The procedure for a supplementary demand is the same as for an original demand, from its presentation down to the authentication of the schedule. Supplementary demands arise in spite of every care taken to include in the budget all probable payments which will have to be made during the financial year. They are none the less looked upon with jealousy by the Legislature, inasmuch as they tend to diminish its control over public expenditure, and, if for large sums, really amount to a breach of contract between the Government and the Legislature. But supplementary estimates are perhaps the lesser of the two evils confronting the Legislature. For, if such estimates were totally stopped, the Executive would, by framing liberal estimates of expenditure, heap up sufficient provision for reserves for unforeseen contingencies. In this manner they would avoid the necessity of approaching the Legislature altogether, whereas when a supplementary estimate is presented the Legislature gets an opportunity of scrutinising and expressing its opinion on the matter.

**Token demands.**—Supplementary demands are also sometimes moved not because funds are not available for the expenditure in question, but because the new item of expenditure is outside the scope of a demand or is of such an important character that it is not considered desirable to spend money without first bringing the matter to the notice of the Legislature and obtaining its formal approval. Such a demand is generally moved for a nominal amount of, say, one rupee, and it is explained in a separate statement how the balance will be met, namely, by transfer of savings under other items. Such a demand is known as a 'token' demand. Token demands are a common feature of budgetary procedure in India.

**The voting of taxes.**—Hitherto we have been dealing with the voting of expenditure. We now come to the voting of taxes, which is an equally important part of the voting of the budget. In providing funds for the needs of the administration, recourse is had to fresh taxation or alterations and additions in the existing scale of taxation, which can in some cases be done by executive action, e.g., land revenue, excise (provincial),

etc., but generally involves legislation and therefore the approval of the Legislature. As funds are equally necessary, whether the expenditure be votable or non-votable, the Legislature, in voting the taxes, gets a further opportunity of reviewing the entire financial policy of Government. By refusing to vote funds to the extent demanded the Legislature can compel Government to retrench, possibly, on non-votable items of expenditure.

The constitutional position of the Executive and the Legislature in the matter of taxation has already been explained. The Executive has no power to tax, except in accordance with the law. The Legislature has no power to propose a fresh measure of taxation or increase the existing burden of taxation, without the concurrence of the Executive Government. In other respects, taxation bills are dealt with by the Legislature in exactly the same manner as other bills, and do not therefore, require specific mention.

**The Finance Bill.**—In most of the provinces, proposals for taxation are put before the Legislature in separate bills and not in a single bill, and the taxation, when sanctioned, is more or less of a permanent character and is not limited in duration to one year. It may, therefore, easily happen that if the revenue and expenditure balanced on the existing scale of taxation, the budget would be finished and done with after the expenditure was voted. Prior to the introduction of the Montagu-Chelmsford reforms, the practice at the Centre was also the same as in the provinces today. Since 1921, however, the convention of introducing a Finance Bill, which has been in force in Great Britain for a long time, has been followed. There are two essential features of a Finance Bill. In the first place, all taxation proposals are included in one bill, instead of four or five separate bills. This facilitates discussion and concentrates attention on the financial position of the country. It also saves time, for if four or five separate bills were introduced, their passage through both the Chambers would take much time and the discussion may not be finished before the new financial year begins. On the other hand, there is the disadvantage that if the Finance Bill is thrown out or delayed in passing beyond 31st March, the whole financial machinery is thrown out of gear. The second feature of the Finance Bill is that the duration of some of the items included in it is limited to one year. In the Centre, for example, Salt-Tax and Postage and Income-tax rates are voted every year. By this device the Legislature gets an opportunity every year of reviewing the entire taxation policy of the Government.

It is, however, not possible or feasible to include every fresh proposal for taxation in a finance bill. Only such proposals can be included whose principle has already been accepted by the Legislature and where the only point for consideration is the variation in the rate of the tax in question. Where an entirely new tax is being proposed, it must ordinarily be the subject of a separate bill. Otherwise, the discussion of the Finance Bill would become very complicated and it would ordinarily not be passed before the commencement of the new financial year.

**The Provisional Collection of Taxes Act.**—The Finance Bill is introduced in the Legislative Assembly on the same day on which the budget is presented. Its passage through the Legislature, however, takes some time and where changes in customs and excise duties are proposed, there is the danger of loss to Government by the passing of goods through the Customs or the removal of goods from bond in the interval between the introduction and the passing of the Bill. It has accordingly been found necessary to give the Executive power to collect during this interval customs and excise duties at the new rates provisionally, in anticipation of their approval by the Legislature. Such a power has been conferred on the Central Executive by the Provisional Collection of Taxes Act. Under this Act, retrospective effect can be given to a Finance Act for a period of 60 days. Thus the Government has to get the Finance Bill passed through the Legislature within a period of 60 days from the date of its introduction. If this period of 60 days is over and the Legislature has not dealt finally with the Bill, the extra duty realised under the provisions of this Act has to be refunded. If the Bill is passed into law by the Legislature in a modified form, the Bill has effect under the Provisional Collection of Taxes Act, as so modified, that is to say, if the Legislature reduces the taxation proposed by the Government any duty collected in excess has to be refunded.

With the development of indirect taxation by the provinces under their new powers, they may also find it necessary to enact such legislation.

## CHAPTER V.—BUDGET CONTROL SYSTEM AND REVIEW OF CONTROL.

When a plan of a house has been approved, it has to be carried out and somebody has got to see that the house is built according to the plan and that if there are any deviations here and there they are duly approved. Similarly in the case of the budget. The Executive Government spends the money and it has got to satisfy itself first and then the Legislature that the money is spent for the purposes for which it was voted. For its own satisfaction a system of budget control has been devised, and for the satisfaction of the Legislature there is the review by the Public Accounts Committee. Both these are dealt with in this chapter.

**Distribution of grants.**—As soon as the final proof of the Estimates is sent to the press, the work of distributing the grants amongst the various disbursing and controlling officers is taken up. This work becomes somewhat onerous when lump sum reductions are made in the estimate of departmental officers, either by Government or by the Legislature. Particularly is it the case when the estimates of departments, such as medical, education, police, jails, etc., are affected, as the reduction has to be spread over a large number of separate estimate by districts and over numerous detailed heads in each district.

**Sub-heads of appropriation.**—Within a grant as voted by the Legislature there are what are called 'sub-heads of appropriation'. A sub-head of appropriation is a head subordinate to a minor head of account and is the lowest unit for the purpose of allotment of funds. It is the pivot on which turns the entire machinery of budget control. Each officer is required to see that the expenditure under the sub-head with which he is concerned does not exceed the budget provision and that if such excess is likely to occur steps are taken in time to get additional funds allotted for it by the competent authority. It is equally his duty, if he finds that the amount provided under a sub-head is in excess of what he is likely to require, to see that any such saving is surrendered without delay to the Finance Department. As a grant is built up of several sub-heads, it is obvious that the expenditure on the grant as a whole will be kept within the budget provision if the expenditure on the sub-heads is not exceeded. The following are the more common sub-heads of appropriation adopted in the grants—

1. Pay of officers.
2. Pay of Establishments.
3. Allowances and honoraria, etc.
4. Contingencies.
5. Grants-in-aid, Contributions, etc.
6. Petty construction and repairs.
7. Works.
8. Assignments and compensations.
9. Charges payable to other Governments, Departments, etc.
10. Suspense.

In the case of funds for expenditure upon Civil Works, the following heads are generally prescribed in place of (7)—

- (a) Original works,
- (b) Repairs,
- (c) Tools and Plant.

Similarly in the case of funds for expenditure upon irrigation, navigation, embankment and drainage works, the following heads are generally prescribed in place of (7)—

- (a) Works.
- (b) Extensions and improvements.
- (c) Maintenance and Repairs.
- (d) Tools and Plant.

A sub-head of appropriation includes provision both for voted as well as non-voted expenditure. The provision under each class is exhibited separately under each sub-head.

**Appropriations and re-appropriations.**—No Government servant can spend any money until both the following conditions are satisfied :—

- (1) The expenditure has been sanctioned by a general or special order of the authority competent to sanction such expenditure, and
- (2) Sufficient funds have been provided for the expenditure in a Schedule of authorised expenditure for the current financial year, or by a re-appropriation of funds by the authority competent to sanction such a re-appropriation.

It has been stated in the chapter on Financial Control that Government has fixed the financial powers of each administrative authority. The power to accord sanction to expenditure is one such power and the power to sanction a re-appropriation is another. The Audit Department receives copies of all financial sanctions and has to see that no authority exceeds its powers either in the matter of sanctioning expenditure or in the matter of sanctioning re-appropriations.

Appropriation means the amount provided in the budget estimates for a particular purpose.

Re-appropriation means the transfer of funds from one purpose to another. No budget, however skilfully prepared, can dispense with the necessity for re-appropriations. Though there are orders that expenditure for which no provision has been made in the budget should not be incurred, unforeseen circumstances arise which make it impossible to put off all such expenditure. For instance, if owing to heavy rains a bridge or an irrigation canal is breached, the breach must be repaired immediately, even if there are no funds in the budget. The public will neither understand nor tolerate an inconvenience caused to it merely on a technical ground of no allotment of funds. Sometimes, there are *bona fide* errors of omission : provision is not made for expenditure which could have been

anticipated. As soon as it is anticipated that expenditure, which is either not provided for in the budget or is in excess of the budget provision, has to be incurred a formal application for additional funds is necessary. The reason for considering it indispensably necessary that the outlay should be immediately incurred and not postponed to the next financial year has to be stated. It has also to be explained why the need for the expenditure was not foreseen in time for its inclusion in the budget estimates.

A grant cannot be exceeded without the sanction of the Legislature. But within a grant, the Government has full powers to transfer provision of funds from one sub-head to another.

**Control of expenditure.**—It is an axiom of financial control that for every grant there must be an authority responsible for its administration and particularly to see that the expenditure is kept within the funds allotted for the purpose. It is also generally agreed that this authority must be the administrative head of the department or some other officer connected with the administration and not the Accountant-General. The Accountant-General comes in only as an expert adviser to acquaint the administrative authorities with the facts as ascertained from the accounts from time to time.

The funds voted by the Legislature for expenditure during a financial year are, as far as that body is concerned, moneys placed at the disposal of the Executive Government as a whole for expenditure on certain of its activities, and the Executive Government has no power to spend more on those activities than the amounts voted by the Legislature. The funds so voted are actually spent by a large number of individual (disbursing) officers, no one of whom, generally speaking, has any knowledge of how much money another may have spent.

The machinery which the Government have devised for discharging their responsibility in the matter consists of the grouping of disbursing officers under various controlling officers, the latter being directly responsible to Government for the control of the expenditure of their particular groups. The grouping is generally on a departmental basis with the departmental head as the controlling officer. The funds voted by the Legislature are placed by Government at the disposal of the controlling officers concerned, whose duties are to exercise a continuous and well informed vigilance over current and anticipated expenditure in order to see that the amounts so placed at their disposal are not exceeded without additional funds being obtained in time, and that any amounts which they find they cannot use are promptly surrendered to Government. A controlling officer may either distribute his grants in detail among his disbursing officers, restricting their expenditure to the amounts he gives them, or may retain the funds wholly or partly under his own direct control. To facilitate control, he is vested with certain limited powers of re-appropriation. Disbursing officers are required to submit to their controlling officers monthly detailed accounts of their expenditure, which the controlling officer compiles in his office into a consolidated account showing the total expenditure up to date against each sub-head of appropriation for which he is responsible. The idea is to give the controlling

officer early and sufficiently accurate information of his financial position in detail, and to keep him in touch with his commitments. Early information is vital to successful control. The departmental accounts are then reconciled with the accounts kept by the Accountant-General, in order to eliminate discrepancies which might defeat control.

**Review of control.**—It is a recognised provision in the financial systems of countries enjoying responsible government that there should be a review of transactions after the budget has been executed. It is clearly useless to give to the Legislature the power of voting money for particular purposes unless the Legislature is assured that the money is spent by the executive for the purposes for which it was voted. As Professor Bastable says in his "Public Finance", "the most admirable provisions respecting the preparation and vote of the Budget will be useless, unless there is adequate machinery to secure conformity to the determinations of the Legislature".

The plan adopted to secure such conformity is :—

- (a) to subject the public account to an independent audit; and
- (b) to appoint a committee of the Legislature to go through the audited account and the report of the auditor thereon.

It has been stated in the chapter dealing with audit that it is an important part of the duties of an auditor to see that expenditure is kept within the grant and that no amount is spent for an unauthorised purpose. As a result of the scrutiny applied in audit, the Accountant-General prepares what is called an 'Appropriation Account' for each grant, in which is indicated the amount granted and the amount spent under each sub-head and on the grant as a whole. Explanations are given for important variations between the amount granted and the amount spent under each sub-head. If there is an excess in the grant as a whole it is stated that the excess requires regularisation by the Legislature.

The second part of the machinery referred to above is provided in the shape of the Public Accounts Committee, the constitution and functions of which are explained below :—

**Public Accounts Committee.**—At the commencement of each session, a standing committee of the Legislature, at the Centre and in the provinces respectively, is constituted for the purpose of scrutinising the appropriation accounts and the audit report thereon, and such other matters as the Finance Department may refer to it. The committee consists of members elected by the Legislature, including the Finance Minister who is an ex-officio member. The term of office of members of the committee is one year, but any member is eligible for re-election. The chairman is elected by the committee from among their members. In the case of an equality of votes on any matter, the chairman has a second or casting vote. In England, the convention is that a well-known member of the Opposition is selected as chairman, so that there may be proper opportunity for review and criticism, if necessary, of the financial proceedings of the Government of the day. But in India the practice hitherto has been to elect the Finance Minister as chairman.



The Accountant-General is not a member, but is usually invited to attend the meetings of the Public Accounts Committee. In the case of the Central Public Accounts Committee, the Auditor-General is also similarly invited.

The main function of the committee is to see that the money granted by the Legislature has been spent by the Executive within the scope of the demand. This means that the committee has to satisfy itself that :—

- (i) the money recorded as spent against the grant is not larger than the amount granted ;
- (ii) the money has not been spent for a purpose not approved of by the Legislature ;
- (iii) there are no other irregularities in the spending of public money by the Executive.

Strictly speaking, the committee is concerned only with voted expenditure, but by a convention which has been observed ever since the introduction of Public Accounts Committees, the committee deals with both voted and non-voted expenditure. In cases where accounts of receipts and of stores and stock are audited by the Auditor-General, the committee also considers the audit reports thereon in much the same detail as in the case of expenditure.

The committee has the power to examine the representatives of the departments concerned and to summon the officers more directly responsible whenever necessary. The committee is entitled to offer criticisms and recommendations upon any matter discussed in an appropriation account or in the audit report thereon. But the committee is not an executive body. It has no power, even after the most minute examination and on the clearest evidence, to disallow any item or to issue an order. It can only call attention to an irregularity or to failure to deal with it adequately and express its opinion thereon and record its findings and recommendations.

After it has completed its examination of the accounts, the recommendations of the Committee are embodied in a report which is laid before the Legislature. A day is usually allotted for the discussion of the report, when several important points are raised which are of great interest to the general public. Excess votes are taken in respect of amounts spent over and above the grant authorised by the Legislature in each case.

**Finance Accounts.**—Section 169 of the Government of India Act, 1935, contemplates that the Auditor-General will report on the accounts of a province or of the Federation and the wording of the Section makes it clear that his report is not confined to Appropriation Accounts. Appropriation Accounts do not cover the entire receipts and disbursements of Government but relate only to that part of the public expenditure which comes before the Legislature in the form of demands for grants. Besides this class of expenditure there are other disbursements, such as under debt, deposit and remittance heads. The accounts of revenue and other receipts of Government are also outside the scope of the Appropriation Accounts. To fill this gap in the public accounts, a separate compilation known as the Finance Accounts is prepared for each

province and the Centre and presented to the Legislature with a report thereon by the Auditor-General. The Appropriation Accounts and the Finance Accounts, each with the Audit Report thereon, collectively constitute the accounts and report of the Auditor-General under paragraph 11(4) of the Government of India Audit and Accounts Order and Section 169 of the Government of India Act.

The Finance Accounts give complete information regarding the public account for the year, both under receipts as well as expenditure. The Audit Report on the accounts brings out the salient features of current revenue and expenditure, the financial results of important public works, together with an analysis of the debt position, showing how much of the debt is productive and how much is unproductive and what arrangements are made for the redemption of debt and whether such arrangements are or are not adequate. The general summary of the financial position included in the Audit Report is of particular interest, as an authoritative and impartial review of public finance.

The Public Accounts Committee is statutorily concerned with the Appropriation Accounts only, but there is nothing to prevent the Legislature directing that the Finance Accounts be examined by the Public Accounts Committee and dealt with in the same manner as the Appropriation Accounts.

Appropriation Accounts are of value as a part of the scheme of parliamentary financial control, but the Finance Accounts are more interesting from the point of view of the public taxpayer, the members of the Legislature and others interested in public finance. For this reason the Finance Accounts are made available to the Legislature before the Budget for the coming year is taken up for consideration. It is expected that they will help the Legislature in following the Budget and properly appreciating the proposals either for fresh taxation or remission of revenue or for flotation of loans.

**General observations.**—Having explained the system, it is now necessary to discuss its working. Public Accounts Committees have been in existence in India now for a number of years. Have they done any useful work and if so, what?

The system of appropriate audit introduced in India is primarily designed to secure regularity of expenditure. By regularity we mean the spending of money for the purposes and in the manner prescribed by law. The entire machinery of financial control, particularly of parliamentary control is directed towards that end. The whole elaborate structure of appropriation audit has little or nothing to do with economy or efficiency in financial administration, except to the extent that if regularity were not insisted upon, there would be extravagance. But it is generally correct to say that the system is intended to secure and does secure regularity only. The securing of economy is left generally to the departments themselves in the first instance and to a certain extent to the Finance Department. Constitutionally speaking regularity is important, but from the point of view of the taxpayer, economy is more important. It is quite possible to spend money without constitutional irregularity and yet to spend it very wastefully. Moreover, the working of any

machinery depends to a great extent on the men called upon to work it. Whether parliamentary control of public finance is effective or not, depends upon the men composing the Legislatures and the Public Accounts Committees, as also upon the interest that the general public and the press take in orderly finance. As Mill has said :—

“ Publicity is no impediment to evil nor stimulus to good if the public will not look at what is done.”

Bearing the above remarks in mind, it is gratifying to record that the system of parliamentary control of finance introduced in India has led to very useful results. In this connection, the observations of Sir Ernest Burden, Auditor-General of India, in his review of the work of the provincial Public Accounts Committees on the examination of the appropriation accounts of 1932-33 will be read with interest.—

“ The manner in which the business of the several Committees has been transacted has been exceedingly satisfactory and of great practical value to my Department and I wish to repeat the opinion I expressed last year that in general the Public Accounts Committees exercise an increasingly effectual and salutary influence on the administration of public finance.”

One important result of the steady pressure exercised by Public Accounts Committees in India in the matter of regularity of expenditure has been that the margin of difference between estimates and actuals has been considerably reduced, as will be seen from the statement given below for 1921-22, when Public Accounts Committees first began to function, and for 1936-37 :—

*Statement comparing estimates with the actual expenditure (voted and non-voted) charged to Revenue for 1921-22 and 1936-37.*

(in thousands of rupees.)

	1921-22.			1936-37.		
	Estimates.	Actuals.	Percentage of variation. Savings— Exces. +	Estimates.	Actuals.	Percentage of variation. Savings— Exces. +
Central Government .	1,27,60.43	1,41,86.52	+11.9	1,22,70.12	1,19,62.61	—2.5
Madras . . . . .	17,07.61	16,06.00	—7.8	15,90.15	15,77.37	—.8
Bombay . . . . .	16,04.96	16,31.00	+1.6	12,03.17	11,99.47	—.3
Bengal . . . . .	12,59.61	12,03.00	—4.5	11,90.77	11,74.16	—1.4
Punjab . . . . .	11,58.41	10,83.00	—6.5	10,77.85	10,83.55	+ .5
Bihar and Orissa .	5,09.74	4,88.00	—8.2	4,81.73	4,66.03*	—1.3
Assam . . . . .	2,56.78	2,24.00	—12.8	3,00.39	2,92.17	—2.7
United Provinces .	13,73.73	14,11.00	+2.7	12,44.56	12,29.26	—1.2
Central Provinces .	5,44.02	5,27.00	—3.1	4,89.71	4,81.25	—1.7

\* [ Figures are for Bihar only not for Orissa. ]

## CHAPTER VI.—PUBLIC DEBT.

There is a facile tendency in democracies to shift to posterity burdens which should be borne by the present generation. When public finances are discussed, attention is generally concentrated on the budgetary position—the position as regards current revenue and current expenditure. But an equally, and, indeed, sometimes much more important, branch of public finance is the capital expenditure and public debt position. Unsound practices as regards what is treated as the subject for loan expenditure can undermine any budgetary position. In times of exceptional difficulty, there is a great temptation to say—

“Let us abandon the attempt to meet the expenditure out of revenue. The public cannot stand the burden. Let us raise a loan instead.”

But the adoption of such a course does not relieve the public of the burden. The idea that there is nothing to worry about in raising a loan so long as provision for interest charges and the annual Sinking Fund instalment is made from current revenue leads to reckless borrowing and a position is soon reached when the interest and sinking fund payments consume the major portion of the revenue and very little is left for the other activities of public administration. This habit of arranging life on the ‘instalment system’ leads to difficulties even in private life, which, however, attractive and convenient in the beginning, resolves itself ultimately into a dreary and apparently endless succession of weekly and monthly payments on the radio, the car, the electric refrigerator, the furniture, etc. Sooner or later, the instalments fall in arrears, and people begin to realise that instead of two and two making eight, as they had hoped, they only make four.

**Volume of debt.**—The total debt on 31st March 1937 of India as a whole, that is, of the Central and Provincial Governments viewed as a single unit, was Rs. 1,209 crores. Of this Rs. 1,179 crores pertained to the Central Government and Rs. 30 crores to Provincial Governments. Out of the former amount, a sum of Rs. 138 crores had been utilised by the Central Government for making advances to provincial governments. The total provincial debt, considered separately, should therefore be reckoned as Rs. 138 crores plus Rs. 30 crores or Rs. 168 crores in all. The total revenues of the Central and Provincial Governments for the year ended 31st March 1937—taking only net revenue in the case of commercial departments, like railways, irrigation, posts and telegraphs, and gross revenue in other cases—amounted to about Rs. 210 crores. The total indebtedness of the country amounts therefore to about six years’ revenue. The estimated population of British India for the year 1936 (figures taken from the Report of the Public Health Commissioner with the Government of India for 1936) was nearly 282 millions. Per head of population the burden of indebtedness comes to Rs. 43.

**Classification of debt.**—The public debt of a country is generally of two kinds :—

- (a) Permanent,
- (b) Floating.

The term 'permanent debt' covers all debt which at the time of issue has a currency of more than 12 months. The term "floating debt" is applied to borrowings of a purely temporary nature with a currency of not more than 12 months.

In addition to permanent and floating debt, there is what is known as 'unfunded debt', a name applied to a group of interest-bearing obligations, such as State provident funds, postal savings bank deposits, postal cash certificates etc.

The 'permanent debt' of India consists of rupee loans floated in India and sterling loans floated in England. Of the total debt of Rs. 1,209 crores at the end of 1936-37, the permanent debt was Rs. 923 crores and the floating debt Rs. 28.5 crores, the balance of Rs. 257½ crores being "unfunded debt". The permanent debt was divided into rupee debt amounting to Rs. 447 crores and sterling debt amounting to £357 millions or Rs. 476 crores at 1s. 6d. to the rupee.

The 'floating debt' mostly consists of 'ways and means' advances and 'Treasury Bills', which are explained below :—

**Ways and means advances.**—It generally happens that public revenue does not come in regularly and uniformly throughout all the months of the year, whereas expenditure is more or less distributed uniformly throughout the year. For instance, in India current revenue generally falls short of current expenditure in the period from April to December ; the last quarter from January to March registers a good surplus of revenue over expenditure. Also, sometimes, exceptionally heavy payments have to be made at a certain period of the year by when the revenue has not sufficiently accumulated to meet them. To enable them to tide over such temporary difficulties, governments take advances from the bank with which they do their financial business. Such advances are known as 'ways and means' advances. Both the principal as well as the interest of such advances are usually repaid as soon as the revenue comes in and in any case by the end of the year.

**Treasury Bills.**—The purpose for which Treasury Bills are issued is the same as in the case of ways and means advances, namely, to finance a Government's temporary excess of expenditure pending the collection of revenue. But, whereas, ways and means advances are taken only from the Reserve Bank, Treasury Bills are issued to the public. They are for short periods, from 3 to 6, 9 or 12 months. Treasury Bills may also be renewed from time to time, in which case they are really a part of the permanent debt of the country kept in a floating form.

There are several considerations which enter into the decision whether to take a ways and means advance or to sell treasury bills on a particular occasion. First the size of the requirements has to be considered. If the amount required is small it is not worth while to have recourse to Treasury Bills. A ways and means advance is more suitable in such a case. Secondly, the period of the requirement has to be considered. If the deficiency is to last for less than three months, a ways and means advance is the better course. Where the deficiency exceeds three months, Treasury Bills are generally more suitable but the state of the money

market at the time of their repayment must also be taken into consideration. Lastly, the comparative cost of the two alternative courses must be the chief consideration. The rate of interest payable is the main factor; also the fact that while a ways and means advance can be repaid at any time and therefore interest is payable only for the period it is outstanding, in the case of Treasury Bills, repayment cannot be made earlier than the term of the issue in question and interest has to be paid for the full period.

**Unfunded Debt.**—The unfunded debt of Rs. 257½ crores at the end of 1936-37 was made up of Rs. 236½ crores pertaining to the Central Government and Rs. 21 crores pertaining to the Provincial Governments. As already stated the principal items of such debt were State provident fund deposits, postal cash certificates and postal savings bank deposits. The postal cash certificates require special mention. From 1924 to 1934 there was a steady increase in the annual balances under this category, and the issue of these certificates helped very considerably in financing the capital programme of the Government. But latterly the tide has turned, owing to a reduction in the rate of interest, and the repayments are now greater than the issues in a year. The total amount of debt outstanding on this account at the end of 1936-37 was Rs. 64 crores.

Another important item of unfunded debt is the Post-office savings bank deposits. The post office savings bank is the most far-reaching agency created for the promotion of thrift and is popular with all classes of people. It is to be hoped that as the number of post offices in rural areas increases, the peasants and agricultural labourers will be drawn to the portals of the post office savings bank in increasing numbers. Unlike the postal cash certificates, the postal savings bank balances continue to increase from year to year and as the rate of interest paid on these balances is low, they are of great assistance in financing the ways and means programme of the Central Government. During the year 1935-36, for instance, the total deposits amounted to Rs. 48 crores and the withdrawals to Rs. 39 crores, or, in other words, Government were able to raise a loan of 9 crores at 2½ per cent. The total amount outstanding on 31st March 1937 was Rs. 75 crores.

Postal certificates and postal savings banks are the concern of the Central Government alone. Balances on both these accounts are very large and are all repayable on demand. In a time of emergency, repayments if demanded on a large scale, may easily become source of anxiety to the Government of the day.

**Productive and unproductive debt.**—The major portion of the Indian National Debt is productive, or, in other words, has been spent on commercial undertakings which yield a net return to the Exchequer. The most important commercial undertakings are Railways, on which Rs. 789 crores have been spent and Irrigation works which have cost Rs. 151 crores. The outlay on non-commercial departments incurred out of loan funds amounts to Rs. 59 crores, in which is included the outlay of Rs. 15 crores on the New Capital at Delhi and of Rs. 9 crores on the Bombay Development Scheme. There is, also, a contribution of Rs. 150 crores on account of the Great War, made by India to His Majesty's Government in Great Britain, which is classed as unproductive. Thus the total unproductive

debt of India is a little over Rs. 200 crores, the balance being all productive. Compared with other countries, the unproductive debt of India is very small. This is due to the adoption of a conservative policy in the matter of borrowings by the Government of India, as has been already pointed out in another chapter.

Owing to the fact that the major portion of the public debt is productive, the real burden of the debt on the taxpayer is small. The only portion of the interest charges which has to be borne by the general taxpayer is on account of outlay in non-commercial departments, as interest on capital outlay in commercial departments is paid out of the net earnings of the departments concerned. To illustrate this in figures, the total interest payments in 1936-37 (considering Central and Provincial Governments together) amounted to Rs. 48 crores, of which about Rs. 37 crores was recouped from commercial departments, leaving only a net burden of Rs. 11 crores to be borne by the general taxpayer.

**Redemption of public debt.**—Before the Great War, the rupee borrowings, of the Government of India in any particular year seldom exceeded Rs. 3 crores and the loans raised were generally non-terminable that is to say, there was no obligation on the part of Government to repay the principal of the loan, the only obligation being to pay the interest to creditors at stated intervals. There was therefore no particular necessity to make adequate arrangements for the redemption of the debt out of the annual revenues. After the War, the loan policy of the Government underwent a radical change. In the first place, the scale of rupee borrowings was enlarged, the idea being to raise as much as possible in India and as little as possible in England. Secondly, in common with other Governments, public loans raised after the War were generally of a terminable character. Therefore the question of their redemption had to be taken into account.

Prior to 1925-26, there was no systematic scheme followed by the Government of India for the amortisation of debt, although, in practice, much borrowing was avoided by the utilisation of revenue surpluses for capital expenditure on railways and irrigation. For wiping out liabilities incurred in connection with the purchase of certain railways, sinking funds were established by Acts of the British Parliament. Apart from this, there was no sinking fund established by law, as in England, for making regular provision for repayment of debt.

With effect from 1925-26, a general scheme of debt redemption was adopted by the Government of India. An annual charge was made against Central revenues made up as follows:—

(a) A sum of Rs. 4 crores and

(1) Such additional sum as was equal to  $\frac{1}{80}$ th of any excess in the total debt on 31st March of the preceding year over that on the 31st March 1923, the sterling debt being converted into rupees at Rs. 15 per £ for this purpose.

The scheme was framed so as to result in the extinction of the productive debt of India in 80 years and of the unproductive debt in a much shorter

period. It was in force up to 1928-29 and was further continued up to 1932-33 with the modification that the sterling debt was converted at Rs. 13-1/3 to the £. The world economic depression forced many countries, in their anxiety to present balanced budgets, to reduce amortisation payments and sinking funds. The same tendency asserted itself in India when railways ceased to make any contribution to general revenues, as they were expected to do under the separation convention, and the annual provision for debt redemption, so far as the Central Government is concerned, has been reduced to Rs. 3 crores since 1933-34.

In regard to provincial debts, the arrangements for amortisation are as follows : --

The pre-autonomy debt of the provinces to the Centre has been cancelled in the case of Bengal, Bihar, Assam, North West Frontier Province and Orissa. Some portion of the debt of the Central Provinces to the Centre has also been cancelled. The balance of the pre-autonomy debt, taken at different times at varying rates of interest, has been consolidated, in the interests of future provincial credit, into a single debt carrying a single rate of interest and repayable in 45 years by means of annual equated payments of principal and interest. These sums are provided by the provinces out of their annual revenues and are non-votable.

We next have to consider the open market loans of the provinces. In relation to such loans, the provision for amortisation is governed entirely by the terms of the notification of each loan. The post-autonomy loans generally provide for a depreciation fund of 1½ per cent. per annum to prevent large fluctuations in market rates over the issue price. Apart from this fund, the provinces retain a free hand in making provision for amortisation.

There are no general principles which are uniformly observed by Governments in the matter of provision for redemption of debt. Amortisation arrangements for loans for unproductive purposes may be related to some extent to the period of maturity of the loan, and also to the chances of growth of the particular type of unproductive debt. It is, however, sounder and more prudent to relate the arrangements rather to the object of the borrowing than to the currency of the actual loan. The period ought to be comparatively short where the expenditure on the unproductive purpose should more properly be met from revenue, where the assets constructed from the loan are comparatively short-lived, or where the total of the borrowings for the unproductive purpose is likely to increase rapidly. Where a material asset is produced the amortisation period should never exceed the life of the asset.

The arrangements for the amortisation of loans for productive purposes depend on the particular circumstances of each case. Where the net earning power of an asset substantially exceeds the interest on the debt, amortisation is not very necessary, though it is sound and prudent financial policy to make amortisation arrangements even in connection with the most productive debt. In the case of borrowings to finance loans to cultivators and others, the actual recoveries of principal may be sufficient debt repayment if used for that purpose provided all losses etc., are



written off to revenue. Normally the rate of amortisation should be related to the life of the revenue producing asset for the construction of which the debt was incurred.

**Administration of the public debt.**—The general control of the administration of the public debt vests in the Finance Department of the Government concerned, each Government, Central or Provincial, being responsible for its own portion of the public debt. Subject to this general control, the administration of the public debt and the maintenance of the accounts relating thereto are vested in the Reserve Bank of India, under agreements concluded with each Government, as provided for by the Reserve Bank of India Act. Generally speaking, the duties of the Reserve Bank comprise the issue of new rupee loans, collection and payment of interest and principal and the consolidation, division, conversion, cancellation and renewal of securities of the Government and the keeping of all registers, books and accounts in connection therewith. For the management of the public debt, the Bank receives a commission at the rate of Rs. 2,000 per crore per annum on the amount of the public debt at the close of the half-year for which the charge is made.

The Bank is also the sole agent for investments by Government, either of Government funds or of funds managed by the Government and is entitled to charge commission for such transactions. It collects interest and the maturity values of such investments on behalf of Government without charge.

## CHAPTER VII.—CASH BALANCES.

**General considerations.**—In the management of their cash balances, Governments, like bankers, have to bear in mind the following three considerations :—

- (1) Safety.
- (2) Economy.
- (3) Adequacy.

There can be no question of safety being the primary consideration. Government is not a profit-making concern and cannot afford to keep public funds in places where they are not safe or to invest them in business or banks which may promise a rich return but involve at the same time the possibility of loss. Usually, Governments keep monies either in treasuries under their own control or in a Central Bank, subject to proper safeguards.

Economy is also a consideration which will be easily understood. As in banking so in public finance, it is considered the height of skill and business capacity to be able to manage with as low a cash balance as possible. The smaller the cash balance with which a government can work, the greater will be the relief to the general taxpayer and to trade and commerce. A large cash balance must involve the imposition of taxation or the flotation of a loan necessitating payment of interest. It also means so much money withdrawn from the money market and laying idle with Government, without earning interest, and thus prevented from employment in profitable channels in trade and commerce.

Adequacy, is also at least as much important as safety and economy. Government, like a bank, cannot afford to say to its creditors that it cannot pay them on the due date and that they should wait until there is sufficient cash in the treasury. In the interests of its financial credit, Government has to keep a watch over the cash position not only over a whole year or even over a whole month, but from week to week and day to day. It has to see that there is at all times enough cash wherever required to meet Government disbursements.

Stated in the above form, the management of cash balances may appear to be a simple business, but it is a fine art and requires, in addition to administrative finance, knowledge of conditions in the money market and the prevailing trends in business and commerce. The Central Government, in particular, has a bigger problem to face, as compared with the provincial governments, not only because its expenditure is greater than that of all the provincial governments put together, and its operations extend over the whole country, but also because it has to finance heavy sterling obligations, with an income practically all in rupees. Questions of exchange and currency thus come up, solutions of which are not always to be found within the country, and may be dependant on policies to be adopted in London or New York or on a general improvement in world conditions.

**The Reserve Bank of India.**—Under the Reserve Bank of India Act, the Bank is under an obligation to accept monies on account of the Secretary of State, the Central Government, and the provincial governments and to make payments up to the amount standing to the credit of their accounts respectively, and to carry out their exchange, remittance and other banking operations. A similar obligation is placed upon the Central and provincial governments to entrust the Bank, on such conditions as may be agreed upon, with all their cash business. The Reserve Bank has its offices only at Calcutta, Bombay, Madras and Delhi and at other places it employs the agency of the Imperial Bank of India for the transaction of Government business. At places where there is neither an office of the Reserve Bank nor a branch of the Imperial Bank, Government cash balances are kept in the district treasury under the control of district officers. The duty of keeping the district treasury supplied with cash adequate to the requirements of Government business is placed on the provincial government concerned, both for provincial as well as Central transactions. At places where there is a branch of the Reserve Bank or of the Imperial Bank, the Reserve Bank is responsible for meeting the demands of each Government, irrespective of the total receipts on Government account at the place where the demand has arisen, so long as the total balance at the credit of the Government in its books does not fall below the prescribed minimum. The provision of funds at the offices of the Reserve Bank and at the branches of the Imperial Bank and the adjustments made between the two Banks on this account are not, therefore, to its annual receipts and disbursements.

Agreement have been concluded between the Reserve Bank and the various Governments regarding the transaction of Government business by the Bank. Broadly speaking, each Government has to deposit free of interest all its cash balances with the Bank and has to see that its balance on each Friday is not less than a credit of the prescribed amount. If a reduction in the Government balance is anticipated before the following Friday, the Government concerned has to take steps by taking a ways and means advance from the Bank or by issuing treasury bills to ensure that its balance does not fall below the prescribed minimum. In case, the balance of a government falls below the prescribed minimum, the Bank is entitled to charge interest on the shortage.

The Bank receives no remuneration for the transaction of Government business at its various offices and agencies, apart from the payment for the management of the public debt, which has already been mentioned in another chapter. It, of course, derives an advantage from the holding of Government cash balances free of obligation to pay interest thereon and the amount of interest which the Reserve Bank can earn on the Government's minimum balance is supposed to remunerate it for the banking services it renders to Government. The minimum balance for each government has been fixed under its agreement with the Bank by a reference to its annual receipts and disbursements.

**The main problem.**—It will appear from what has been stated above that the main problem is to see that there is enough cash at all times of the year to meet :—

- (1) the minimum balance prescribed for the Government account with the Reserve Bank ; and
- (2) the day to day requirements of treasuries, whose cash business has not been taken over by the Reserve Bank.

The Reserve Bank reports by telegram to each provincial government its weekly balance, immediately after the end of each week. If the provincial government requires information regarding its daily balance, that information also is furnished.

A normal balance is fixed for each district for its treasury and sub-treasuries which do not bank with the Reserve Bank. This balance is fixed so that there may always be sufficient balance for meeting local demands without unnecessarily locking up funds. The Treasury Officers are responsible for keeping their treasury and sub-treasury balances as low as is compatible with the requirements for current expenditure and to deposit excesses over normal balances into the currency chests or to remit them elsewhere, if there is no currency chest at the place where the excess occurs. A report of the cash balance of the district at the end of each week is sent by the Treasury Officer to Government, who watch through these reports that the balances are properly maintained.

In addition to the information which it receives from the Reserve Bank and the district treasuries as indicated above, the Finance Department receives from the various administrative departments periodical forecasts of their anticipated receipts and disbursements during the remaining months of the year. It is thus able to know what the cash position is likely to be from month to month.

To those unacquainted with the mysteries of Government finance, there may be some difficulty in understanding what vigilance is needed in regard to the cash position, when enough revenue has been provided in the budget for meeting the expenditure of the year and arrangements made for floating a loan for capital and other requirements. The difficulty arises on account of two factors, one of space and the other of time. Government transactions are spread over a very large area and it frequently happens that the revenue received in one area is not adequate to meet the disbursements in that area. Funds have accordingly to be remitted to such areas from other areas where there is a surplus of receipts over disbursements. Such remittances have to be made in the most economical and safest manner possible. Apart from this, there is the further complication that the flow of receipts and disbursements is very uneven. The major portion of the revenue is received late in the year, whereas the expenditure proceeds more or less steadily from month to month. The receipts and charges are not evenly distributed among the several days of a month. The salaries and pensions are mostly paid in the first week, while the revenue is received on fixed dates. The daily receipts and payments have therefore to be watched and provision made to cover any expected deficiency in the daily balances. Loans can be raised only at certain times when the money market is not tight, even though the expenditure may have been incurred long before the issue of the loan. Consequently, even though the revenue and other receipts of the year may be

adequate to meet the disbursements of the year there are periods when there is a temporary shortage of cash and the deficiency has to be made good.

It is therefore necessary to keep a watch over the cash position from month to month and even from week to week. Whenever it appears that the balance with the Reserve Bank will fall below the prescribed maximum on any Friday, Government has to take steps to rectify the position, either by taking a ways and means advance from the Reserve Bank or by issuing treasury bills.

**Currency chests.**—Reference has been made above to currency chests and the part played by them in facilitating remittances on government account from one place to another. It is necessary to explain what these chests are and how they are operated upon for the purpose mentioned above.

Under the Reserve Bank of India Act, there is no restriction as to the place where the assets of the Issue Department have to be kept as a reserve against the notes in circulation. All that is required is that the total reserve should not be allowed to fall below the total amount of notes in circulation. Such being the case, the operations of the Issue Department of the Reserve Bank are facilitated, economy of metallic currency promoted and unnecessary movements of coin and notes avoided by the establishment at district treasuries and sub-treasuries of currency chests which contain a portion of the assets of the Issue Department and which are quite distinct from the treasury chests or treasury balances and are required to be kept separately in separate chest and the accounts of which are also outside the general treasury accounts. Into these currency chests are deposited the district surpluses when revenue is coming in and is in excess of the requirements of the district treasury in question. For all such deposits made by the district treasury into its currency chest a corresponding transfer in the opposite direction is made from the Issue Department to the Government balance kept with the Reserve Bank. It will thus be observed that to this extent the transfer to a currency chest at a district has exactly the same effect as if the revenue surplus of the district was remitted by rail to provincial headquarters. Moreover, it frequently happens that during the revenue season most of the district treasuries are surplus while several of them are deficit during the remainder of the year. The existence of these currency chests enables Government to keep funds ready for the use of the treasury later on, thus avoiding the necessity of remitting funds during the deficit season to treasuries from which they were previously withdrawn when surplus during the revenue season. The district treasury is thus enabled to adhere to the normal balance prescribed for it for the respective months in each year without having frequently to remit funds to and fro and incurring heavy remittance charges. It will, of course, be obvious that where a district treasury is constantly and heavily in deficit, the establishment of a currency chest will not prevent for all time the necessity of making cash remittances and a time must come when an actual transfer of coin or notes to such a treasury must take place.

**Home Treasury Balances.**—The revenue of the Indian Government is received in rupees in India, whereas that Government has to incur heavy expenditure in England in sterling, on what are called 'Home charges', and consequently some arrangement has to be made each year for remitting funds to London. Prior to the constitution of the Reserve Bank of India, the requirements of the Home Treasury were met by the purchase of sterling in India by Government from banks and firms on an approved list. These banks and firms instructed by cable their London Agents to pay sterling sold to Government, for credit to the account of the Secretary of State at the Bank of England. The equivalent rupee payments to the banks and firms were made in India from the treasury balances. On the constitution of the Reserve Bank, the purchase of sterling from the Scheduled Banks is now made by the Reserve Bank under Section 17(3) of the Reserve Bank of India Act, and the funds required for the Home Treasury are supplied by the Reserve Bank at the rate of exchange dependent on the prevailing market rates at the time. All sterling transactions of provinces are, in the first instance, charged against central funds, and adjusted later on against provincial revenues.

In ordinary times India exports more than she imports and consequently there is usually a balance of trade in favour of India which has to be cleared by means of actual remittances to India. Advantage is taken of the above-mentioned requirements of trade to remit funds to India during the busy season as indicated above. In this manner funds are drawn for the requirements of the Indian Government in London.

When, however, owing to adverse agricultural conditions, or other reasons, exports are dull and the imports exceed the exports, the demand for remittances is in the other direction, namely, from India to England. When such a state of things occurs the Reserve Bank is under an obligation to sell sterling in exchange for rupees received in India. This transaction, however, is purely in support of exchange and does not help the Home Treasury in getting the funds required in London. It will thus be obvious that the machinery of Government finance is to large extent dependent on trade conditions. So long as India has a favourable balance of trade and the export surplus is sufficient to meet the Home charges there is no cause for anxiety. But should the exports show a downward tendency exchange would begin to fall and would require to be supported in other ways. Even a slight fall in the rate of exchange means a loss to Government, as the amount of rupees to be provided is increased.

---

## CHAPTER VIII.—FEDERAL FINANCE.

**General principles.**—The principles of public finance are essentially the same whether the constitution of a country is federal or unitary. There is the same need for economy and regularity in financial administration and the same machinery for enforcing it. Finance under a federal constitution, however, presents peculiar features which do not arise under a unitary constitution. The peculiarities of federal finance arise from the division of functions and the division of financial resources between the federal and provincial authorities, which are to be found in all federal systems. The various functions of government are first divided between the Centre and the units. This division is not based entirely on considerations of pure theory, but is also determined by the special circumstances governing the formation of each federation. Subject to this qualification, it is generally the case that functions which are of an international character like defence, foreign affairs, foreign trade, or which extend beyond the boundaries of any one unit and therefore need centralised treatment, like posts and telegraphs and broadcasting, are federal. All functions which are connected with the maintenance of law and order, or are associated with nation building, as they are called in India, such as education, medical, public health, industries, agriculture, police, courts of law, etc., are assigned to the units. In between there is an intermediate zone regarding which nothing definite can be said : in some countries they are federal, in others they are State functions.

The main consideration in the allocation of functions usually is, whether a particular function can best be discharged by the Centre or by the units and the allocation is made accordingly. In relation to sources of revenue a similar division is made and the main consideration in making the allocation is not the yield but the agency best fitted to exploit each particular source of revenue ; for instance, land revenue must obviously be provincial, and customs duties federal. Now, it very rarely, in fact, never, happens that the revenues appropriate to federal and provincial exploitation yield precisely the sums needed for the discharge of federal and provincial functions respectively. Thus, paradoxical as it may seem, a sufficiency of financial resources under a unitary system may well result in a deficiency either at the Centre or in the units, by the mere fact of apportionment of resources under a federal system. Special devices, such as grants-in-aid, distribution of proceeds of taxation, etc., have to be adopted to rectify the position and ensure to each partner revenue adequate for the proper discharge of the functions entrusted to it. These devices differ in different federations, but there is one feature which is common to them all: they are the subject of acute controversy and heart-burning among the units and introduce serious complications in the financial relations between the Centre and the units. The distribution of revenues between the Centre and the provinces in India under the new financial settlement is not free from such devices, which will be described later on in this chapter.

No entirely satisfactory solution of the main problem of federal finance, namely, the allocation of sources of revenue between the federation and the federal units, has yet been found in any federal system. The main difficulty arises, as has been hinted at above, from the reconciliation of

principle with actual fact. There are certain general principles which framers of federal constitutions have kept in mind and these are briefly indicated below.

(a) **Uniformity.**—The first principle is that each unit of the federation should contribute towards common burdens on an equal basis ; or, in other words, there should be no preference extended to the people of one unit over those of another as regards the payments that they are called upon to make in respect of federal taxes, duties or other imposts. The soundness of this principle cannot be questioned ; only it is somewhat difficult to apply in practice. There is not in India a clean slate to start from and therefore any scheme of allocation has to adapt itself in a large degree to the existing distribution of financial resources. The taxable capacity of each province is not the same nor is there any equality in regard to income per head of population. Equality of contribution would thus result in unfairness to provinces that are rather backward. In practically every province, the expenditure has been raised to the level of the income and if the income were reduced it would not be possible to cut down expenditure without lowering the standard of administrative progress. To a considerable extent, therefore, the principle of uniformity is watered down in practice by the special devices referred to in the preceding paragraph, so as not to disturb the *status quo* much too much.

(b) **Independence.**—The second principle is that each government in a federation should be vested with independent financial authority, that is to say, each government should have separate sources of revenue, full power to levy taxes, to incur expenditure, to borrow and to lend money, in order to carry out effectively the functions of government entrusted to it. Financial dependence of one government on another must necessarily lead to political dependence, which will in course of time undermine the very foundations of federation. There should be no such thing as doles or contributions from one government to another.

This principle has been given effect to in the new Indian Constitution as far as practicable. Both the Centre and the provinces have been given separate sources of revenue and full powers to exploit them. They have also full powers to sanction expenditure, and to borrow or lend money, as has been pointed out in the first chapter of this book.

There is, however, a great difficulty in giving effect to the principle of 'clean cut' or, complete separation of sources of revenue, inasmuch as it leaves the units without adequate resources and thus conflicts with the principle of adequacy, discussed in the following paragraph. It has accordingly been given up in every federal system. Under the new Constitution, the provinces have, in addition to the sources of revenue assigned to them, shares in Central sources of revenue, such as income-tax export duty on jute, etc. They also receive grants from the Central Government for purely provincial functions, such as road construction, industrial and agricultural development, economic improvement of rural areas, etc.

(c) **Adequacy.**—The third principle is that the resources allotted to each government should be adequate to the discharge of the obligations placed upon it by the Constitution. Such adequacy must have reference not only to existing needs but also to future requirements. It frequently



happens that the units are entrusted with functions which call for increasing expenditure from year to year and therefore even if they are started on an even keel, they find after a few years that their expenditure grows at a much faster rate than their revenue, which is comparatively inelastic. The Centre, on the other hand, has functions which call for more or less even expenditure in ordinary times, but which, during a war or a national financial crisis, are apt to grow disproportionately. Hence, it is noticed that in normal times the growth of Central revenues is at a faster rate than the growth of its peace time expenditure.

Translated in terms of Indian conditions, the requirements of the above principle would be that any scheme of allocation of resources should provide the Centre with (a) a secure means of meeting the normal demand on account of the services for which it is responsible, together with an adequate reserve power to raise from its own resources the additional sums which these services may in an emergency require ; and (b) some additional reserve to meet necessary developments in its own sphere of work. To the provinces it should not only provide funds adequate for meeting their normal expenditure, but also additional funds for the normal growth in the nation building services for which they are responsible.

It has been stated above that any scheme of allocation of resources must satisfy the test of adequacy not only at the time it is framed but also in future. In view of changing industrial and economic conditions, it is necessary to aim at a considerable degree of elasticity in the financial framework. Rigidity in the scheme of distribution of financial resources between the Centre and the units has been the cause of trouble in every federation. There must be provision in the constitution for alteration in the light of circumstances and experience gained. The Government of India Act provides this much-needed element of elasticity in Section 140 (1) which says that the net proceeds of the duties on salt, federal duties of excise and export duties may be distributed to the units under an Act of the Federal Legislature and in accordance with such principles of distribution as may be formulated by the Act.

(d) Administrative expediency.—The fourth principle is that in any scheme of division of resources the interest of the general taxpayer must be paramount. One of the primary objects of federation would be lost if evasion of assessment or defrauding of revenue became widespread, or trade and industry were hampered by differential taxation or local interest in development deadened by overcentralisation. Certain taxes, like income-tax, can be administered properly only by a central organisation, and it would be wrong to give such free play to the two principles of independence and adequacy mentioned above as to overlook entirely the consideration of administrative expediency. The Federation and the units must respectively be assigned such taxes as they are in the best position to administer. What is usually done in federal systems is to centralise the administration of certain taxes and distribute the net proceeds among the constituent units. This is done on purely financial grounds, even though there is a strong objection to it on theoretical and political grounds. To allow one government to levy a tax and another to enjoy its proceeds is to place all the odium on the tax-imposing government and to

destroy all incentive to economy in the spending government. Not only this, but it renders reduction of such taxation very difficult, if not impossible, for all the governments which share the proceeds of the tax have to be consulted before such a step can be taken, and it is very difficult to secure their concurrence.

In India, shares of income-tax and jute export duty, which are administered and collected by the Central Government, are assigned to the provinces, and provision is made in the Government of India Act for the levy and collection by the Federation of succession duties, terminal taxes on goods and passengers carried by railway or air, taxes on railway fares and freights, etc., and the distribution of the net proceeds of such taxes to the units. The prior sanction of the Governor-General is required to bills affecting taxation in which provinces are interested. From what has been said above, this will be readily understood.

**Distribution of resources under the new Constitution.**—Having described the general principles of federal finance in the preceding paragraphs, we now proceed to a description of the distribution of financial resources between the Centre and the provinces under the new Constitution. It will be gathered from what has been stated above, that this distribution is made partly by allocating separate sources of revenue to the Centre and the provinces respectively, partly by distribution to the provinces of net proceeds of certain Central taxes and partly by cash grants from the Centre to the provinces either for general or for specific purposes. In addition, the resources of the provinces have been enlarged by certain financial adjustments, such as decentralisation of balances, consolidation of pre-autonomy debt and cancellation of debt, in the case of certain provinces. We now proceed to describe them as briefly as possible below.

**The Legislative Lists.**—There are three Legislative Lists in the Seventh Schedule to the Act, known as the Federal Legislative List, the Concurrent Legislative List and the Provincial Legislative List respectively. Executive authority in respect of subjects in the Federal Legislative List is vested in the Centre. Executive authority in respect of subjects in the concurrent and Provincial Legislative Lists is vested in the Provinces. The term 'executive authority' includes authority to receive and spend money in the administration of the subjects referred to above. Under Section 136 of the Act, all revenues and public moneys 'raised or received by the Federation' go to constitute the 'revenues of the Federation'. Similarly, all revenue and public moneys 'raised or received by a Province' go to constitute the 'revenues of the Province'. It accordingly follows that all receipts accruing from Federal subjects and all charges of administration thereof are Federal. Similarly, all receipts accruing from subjects in the Provincial and Concurrent Legislative Lists are Provincial, so also all charges of administration thereof.

The main financial items of the Federal List are :—

No. 19. Import and export across customs frontiers as defined by the Federal Government.

44. Duties of customs, including export duties.

45. Duties of excise on tobacco and other goods manufactured or produced in India except :—

(a) alcoholic liquors for human consumption ,

- (b) opium, Indian hemp and other narcotic drugs and narcotics ; non-narcotic drugs ;
- (c) medicinal and toilet preparations containing alcohol, or any substance included in sub-paragraph (b) of this entry.
46. Corporation tax.
47. Salt.
48. State lotteries.
54. Taxes on income other than agricultural income.
55. Taxes on the capital value of the assets, exclusive of agricultural land, of individuals and companies ; taxes on the capital of companies.
56. Duties in respect of succession to property other than agricultural land.
57. The rates of stamp duty in respect of bills of exchange, cheques promissory notes, bills of lading, letters of credit, policies of insurance, proxies and receipts.
58. Terminal taxes on goods or passengers carried by railway or air ; taxes on railway fares and freights.
59. Fees in respect of any of the matters in the list, but not including fees taken in any Court.

The respective importance of the above items will be seen from the Budget of the Central Government for 1939-40 given below :—

1939-40.

(In crores of rupees)

<i>Receipts (Ases).</i>		<i>Expenditure (Net).</i>	
Customs . . . . .	39·81	Defence . . . . .	45·18
Corporation tax and other taxes on income . . . . .	13·97	Debt services . . . . .	12·02
Central Excise duties . . . . .	7·84	Civil Administration . . . . .	10·00
Salt . . . . .	7·33	Civil Works . . . . .	2·47
Railways . . . . .	2·13	Miscellaneous . . . . .	2·25
Other heads . . . . .	·45	Irrigation . . . . .	·09
Currency and Mint . . . . .	·32	Posts and Telegraphs . . . . .	·03
Opium . . . . .	·24	Surplus . . . . .	·05
	72·09		72·09

The main financial items of the Provincial Lists are :—

- No. 19. Water, that is to say, water supplies, irrigation and canals, drainage and embankments, water storage and water power.
22. Forests.
23. Regulation of mines and oil fields and mineral development subject to the provisions of List I with respect to regulation and development under Federal control.
24. Fisheries.

31. intoxicating liquors and narcotic drugs, that is to say, the production, manufacture, possession, transport, purchase and sale of intoxicating liquors, opium and other narcotic drugs, but subject, as respects opium, to the provisions of List I and, as respects poisons and dangerous drugs to the provisions of List III.
35. Theatres, dramatic performances and cinemas, but not including the sanction of cinematograph films for exhibition.
36. Betting and gambling.
39. Land Revenue, including the assessment and collection of revenue, the maintenance of land records, survey for revenue purposes and records or rights and alienation of revenue.
- 40. Duties of excise on the following goods manufactured or produced in the Province and countervailing duties at the same or lower rates on similar goods manufactured or produced elsewhere in India—
  - (a) alcoholic liquors for human consumption,
  - (b) opium, Indian hemp and other narcotic drugs and narcotics ; non-narcotic drugs ;
  - (c) medicinal and toilet preparations containing alcohol or any substance included in sub-paragraph (b) of this entry.
41. Taxes on agricultural income.
42. Taxes on lands and buildings, hearths and windows.
43. Duties in respect of succession to agricultural land.
44. Taxes on mineral rights, subject to any limitations imposed by any Act of the Federal Legislature relating to mineral development.
45. Capitation taxes.
46. Taxes on professions, trades, callings and employments.
47. Taxes on animals and boats.
48. Taxes on the sale of goods and on advertisements.
49. Cesses on the entry of goods into a local area for consumption, use or sale therein.
50. Taxes on luxuries, including taxes on entertainments, amusements, betting and gambling.
51. The rates of stamp duty in respect of documents other than those specified in the provisions of List I with regard to rates of stamp duty.
52. Dues on passengers and goods carried on inland waterways.
53. Tolls.
54. Fees in respect of any of the matters in this List, but not including fees taken in any court.

The respective importance of the main items of revenue actually enjoyed by the Provinces will be apparent from the budget of the Government of Madras for 1939-40 given below, which may be taken to be typical of other Governors' Provinces :—

*Madras Budget, 1939-40.*

(In lakhs of Rupees)

<i>Revenue (Net).</i>		<i>Expenditure (Net).</i>	
Land Revenue . . . . .	474·17	General Administration . . . . .	284·53
Provincial Excise . . . . .	324·18	Education . . . . .	256·97
Stamps . . . . .	162·29	Police . . . . .	155·03
Irrigation, Navigation, Embankment and Drainage Works . . . . .	76·15	Civil Works . . . . .	108·67
Interest . . . . .	68·09	Superannuation Allowance and Pensions . . . . .	100·29
Taxes on Income other than Corporation Tax (Assignment from the Central Government) . . . . .	24·15	Medical . . . . .	87·03
Other Taxes and duties . . . . .	17·64	Administration of Justice . . . . .	75·33
Miscellaneous . . . . .	13·14	Public Health . . . . .	26·16
Receipts under Motor Vehicles Taxation Acts . . . . .	9·28	Agriculture . . . . .	17·77
Receipts from Electric Schemes . . . . .	8·24	Jails and Convict Settlements . . . . .	17·53
Forest . . . . .	4·02	Stationery and Printing . . . . .	15·57
Registration . . . . .	2·16	Miscellaneous Departments . . . . .	14·57
Excess of Expenditure over Revenue (Deficit) . . . . .	17·27	Veterinary . . . . .	11·48
		Co-operative Credit . . . . .	10·05
		Appropriation for reduction or avoidance of debt . . . . .	9·04
		Industries . . . . .	8·49
		Farmine . . . . .	5·00
		Scientific Departments . . . . .	·98
			<u>1202·28</u>
	<u>1202·28</u>		

**Residuary powers of taxation.**—In all federations, the question of residuary powers is very important, as it is believed that sovereignty resides with the authority that is vested with residuary powers. In some federations the residuary powers are vested in the Centre and in others in the units. In India, an attempt has been made, unlike other federations, to enumerate the powers of the Centre and the units as exhaustively as human ingenuity can make it, so as to leave little or nothing to the residuary field. As, however, it is impossible to make any lists of powers so exhaustive as to prevent doubts arising in the future, the Government of India Act endows the Governor-General with power to decide whether the Centre or the constituent units should be empowered to levy any tax not included in either of the three legislative lists. This, necessarily, gives the Governor-General power not merely to allocate an unenumerated tax, but also, in so doing, to determine conclusively that a given taxing power is not, in fact, covered by the enumeration as it stands.

**Assignment of Central taxes to provinces.**—(a) Jute export duty. The net proceeds of the jute export duty, which is Central, are distributed between the various jute growing provinces in the following manner:—

62½ per cent. of the net proceeds of the duty is assigned to Bengal, Bihar, Assam and Orissa. The distribution is on the basis of jute produced in each province. Bengal, as the biggest producer of jute, gets the largest share under this head.

(b) **Income-tax.** 50 per cent. of the net proceeds of taxes on income, other than corporation tax, (excepting proceeds attributable to Chief Commissioners' Provinces or to taxes payable in respect of federal emoluments) is assigned to the provinces and the sum falling to be distributed in any year are distributed among them as follows:—

	Per cent.
Madras . . . . .	15
Bombay . . . . .	20
Bengal . . . . .	20
The United Provinces . . . . .	15
The Punjab . . . . .	8
Bihar . . . . .	10
The Central Provinces and Berar . . . . .	5
Assam . . . . .	2
The North-West Frontier Province . . . . .	1
Orissa . . . . .	2
Sind . . . . .	2

The above however does not come into effect from the 1st April 1937. For the first 5 years commencing from the 1st April 1937 the Provinces will receive each year only the amount by which the sum total of divisible income-tax and railway contribution to Federal Revenues exceeds 13 crores, subject to the maximum of half the divisible income-tax. As this excess is ordinarily less than 50 per cent., this means that the Federation retains a certain portion of the provincial share. For the next period of 5 years there is a gradual reduction of the sum retained by the Federation out of the Provincial share. The sum retained in the last year of the first quinquennium is taken as basis for this purpose and Federation retains only 5/6ths of it in the first year of the second quinquennium, 4/6ths in the second year, 3/6th in the third year, and so on, till in the 11th year the Provinces begin to get their 50 per cent. share in full. The Governor General in his discretion may, however, in any year of the second quinquennium direct that the sum to be retained by the Federation in that year shall be the sum retained in the preceding year, in which case the second quinquennium will be correspondingly extended. The amendment recently made in the Indian Income-tax Act, which will tend to improve the proceeds of the tax, may be expected to result in an increase in the amount assignable to the provinces, but during the first quinquennium the provinces may not get the full benefit of this increase if there is a drop in the contribution from Railways to Central Revenues.

No other Central taxes are at present assigned to the provinces, but reference has already been made to Section 140 under which salt duties, federal excise duties and export duties may be assigned to them in the future.

The Federal List contains items, such as succession duties, stamp duties, terminal taxes, etc., which when levied and collected by the Federation have to be assigned to the provinces and cannot be retained by the Federation for its own use.

**Grants from the Centre to the provinces.**—In all federal system there are grants made by the Centre to constituent units. These grants are of a twofold character : grants in aid of general resources without any conditions attached, and grants for specific purposes subject to the fulfilment of conditions prescribed by the authority making the grant. In India we have examples of both. Section 142 of the Government of India Act, 1935, refers to grants of the first kind and in pursuance of the authority conferred by that section the following amounts are paid as grants in aid of the revenues of the provinces mentioned below, as specified in the schedule to the Government of India (Distribution of Revenues) Order, 1936 :—

1. The United Provinces—25 lakhs of rupees in each year of the first five years from 1st April 1937.
2. Assam—30 lakhs of rupees in each year.
3. The North-West Frontier Province—100 lakhs of rupees in each year.
4. Orissa—47 lakhs of rupees in the financial year commencing 1st April 1937 ; 43 lakhs of rupees in each of the next four succeeding years, and 40 lakhs of rupees in every subsequent year.
5. Sind—110 lakhs of rupees in the financial year commencing 1st April 1937 ; 105 lakhs of rupees in each of the next nine years ; 80 lakhs of rupees in each of the next twenty years ; 65 lakhs of rupees in each of the next five years ; 60 lakhs of rupees in each of the next five years and 55 lakhs of rupees in each of the next five years.

The above grants are subject to no conditions and are in aid of the general resources of the provinces concerned. There is therefore no diminution of autonomy and the Central Government has no right to interfere in financial administration. In addition, there are other grants from the Centre to the provinces which are for specific purposes and which are given on the observance by the provinces of specific conditions prescribed by the Centre. As instances might be cited the following :—

- (i) Grants from the Road Development Fund.
- (ii) Grants from the Rural Development Fund.
- (iii) Grants for the development of hand loom industry.
- (iv) Grants for the development of the sericulture industry.
- (v) Grants from the Sugar Excise Fund.

**Financial adjustments.**—The major sources of revenue of the Centre and the provinces have been briefly described above. Relief has also been afforded to the provinces in certain other respects as a part of the new financial settlement and we now describe these below :—

(1) **Decentralisation of balances.**—With effect from April 1, 1937, not only have the provincial balances been separated from those of the Central Government, but their scope has also been considerably enlarged, as provinces have been handed over balances in regard to debt, deposit and remittance transactions which are of an intrinsically local nature or definitely associated with provincial functions, such as, provident fund deposits, balances of municipal and other local authorities, etc. The liability attaching to these items has also been passed to the provinces concerned. As the receipts under debt, deposit and remittance heads in any one year are as a rule greater than the disbursements, this measure of decentralisation has placed in the hands of provinces resources which they can use for their capital programmes.

(2) **Consolidation of pre-autonomy debt.**—The amounts due to the provinces as a result of the decentralisation of balances mentioned above, were not paid entirely in cash, but were adjusted against the pre-1921 debt owed by the provinces to the Government of India. As this debt carries a rate of interest of about  $3\frac{1}{2}$  per cent., which was above the market rate on 1st April 1937, it has clearly been advantageous to the provinces to cancel a corresponding amount of such debt. The balance of the remaining pre-1921 provincial debt as well as other provincial pre-autonomy debt taken at different times at varying rates of interest has been consolidated, in the interests of future provincial credit, into a single debt carrying a single rate of interest and repayable in 45 years by means of annual equated payments of principal and interest.

(3) **Cancellation of debt.**—In the case of Bengal, Bihar, Assam, North-West Frontier Province and Orissa, all debt contracted with the Centre prior to April 1, 1936, has been cancelled. In the case of Central Provinces, all debt incurred on account of revenue deficits up to 31st March 1936 and approximately 2 crores of pre-1921 debt have been cancelled.

**Financial results of the new settlement.**—All the provinces have benefitted from the new settlement and are in a stronger position financially than before. Some have benefitted more than others, but no one is worse off than before. The net annual benefit in the first year of provincial autonomy to the revenues of each province, as a result of the various



measures taken under the new settlement, is approximately indicated below:—

[In lakhs of rupees.]

Province.	Relief from separation of Provinces.	Subvention under Section 142 of the Act.	Extra 12½ per cent of duty on Jute under Section 140 (2) of the Act.	Net benefit from consolidation or cancellation of debt.	Share from income-tax under Section 138 of the Act.	Total
Madras . . . . .	22	..	..	34·4	20	76·4
Bombay . . . . .	75	..	..	6	27	108
Bengal . . . . .	..	..	49	34	26	109
United Provinces . . . . .	..	25	..	19·3	20	64·3
Punjab . . . . .	..	..	..	2·4	11	13·4
Bihar . . . . .	8	..	2·5	22	18	50·5
Central Provinces . . . . .	..	..	..	18·8	6·5	25·3
Assam . . . . .	..	30	2·5	14·5	2·5	49·5
North-West Frontier Province.	..	100	..	12·3	1·3	113·6
Orissa . . . . .	..	47	·5	8·7	2·8	59
Sind . . . . .	..	110	..	1·6	2·2	113·9