

**THE EVOLUTION OF
PROVINCIAL FINANCE
IN BRITISH INDIA**
**A STUDY IN THE PROVINCIAL
DECENTRALIZATION OF
IMPERIAL FINANCE**

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Dedicated to
HIS HIGHNESS SHRI SAYAJIRAO GAIKAWAD
MAHARAJA OF BARODA

AS A TOKEN OF MY GRATITUDE FOR HIS HELP IN THE
MATTER OF MY EDUCATION

PREFACE

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

Precisely these have been the difficulties besetting the present task. There are no books to prepare the student for his work and hardly any savant to lighten his labour or set him on the proper track. Notwithstanding such odds, an attempt is made to make this study thorough without being too detailed. This has rendered the undertaking quite a laborious one. But I do not wish to speak of the labour that is involved, nor do I wish to astonish the reader with what might appear to be a formidable list of books and documents consulted in the preparation of this monograph. What I am anxious to speak of are its shortcomings. There are indeed many of them which a well-versed critic may spot out. It is my hope that they are not of such a character as seriously to impair the value which this

monograph may otherwise be said to possess. My regrets are with regard to only a few of them. I have specified a date as to when Local Decentralization of Finance commenced in India; but I feel that that date may not be the earliest and that there may be a date earlier than that one given by me. I wish I had settled that point finally. But that would have been a task analogous to that of searching for a needle in a haystack, and it is doubtful whether the value of that result would have been commensurate with that labour. Besides, although I am not confident of my date, my feeling is that later researches may after all confirm my statement. Another matter which I have not dealt with, but which I would have liked to have dealt with, was the inter-relation of Provincial and Local Finance. This I had originally planned to do, but left pursuing it because I found that the chief subject I was dealing with, namely, the Provincial Decentralization of Imperial Finance, began to be overlaid by facts and arguments not germane to that topic. These shortcomings will, however, be removed by a supplementary monograph on Local Finance in British India, which is well under way and which I hope to publish before long. Occasional repetitions may also be pointed out as a defect of this monograph. That they should be avoided is all very well. But where economy in the words of explanation are likely to obscure, repetitions such as are unavoidable must be justified, for the interests of clarification should always outweigh the tedium they involve.

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

FOREWORD

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

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

With the increasing pressure of taxation and the development under modern democracies of augmented governmental functions, the problem of the equitable distribution of burden among

these various forms of government is becoming more or less acute. What Mr. Ambedkar calls assignments, assigned revenue, and share revenue, is symptomatic of the choice of methods in all countries. One of three fundamental plans must be pursued. Either the central or the provincial government may be maintained by the other, according to the relative degree of strength : in former times, in the United States, and in Germany the states were supposed to support the central government, either wholly or in large measure; in modern times, in Canada and Australia, the reverse is true. Or, secondly, distinct revenues may be allocated to the separate governments : until recently the federal government in the United States, Germany, and Switzerland was supported primarily by indirect taxes; the state governments by direct taxes. Or, thirdly, the revenues may be collected by one government and a portion of the proceeds allotted to the other : there are many instances of a state or provincial tax being shared with the federal government, and still more examples of a federal or central tax being shared with the state or provincial government. In the United States at present the proper disposition of the inheritance tax as between state and federal government is fast becoming a burning question; in Germany the fiscal relations of state and federal government are in the forefront of political discussion.

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

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

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INTRODUCTION

DEFINITION AND OUTLINE OF THE SUBJECT

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

Helpful as these sources are, they are not without their puzzles. A reference to the latest volume of Finance and Revenue Accounts will show that the accounts therein are classified under four different categories :—(1) Imperial, (2) Provincial, (3) Incorporated Local, and (4) Excluded Local. But this is by no means uniformly so. For instance, a volume of the same series before 1870 will not be found to contain the accounts called “Provincial”, nor will the accounts styled “Local” be found in any volume prior to 1863. Similarly, any volume of the Financial Statements before 1870 will be found to divide the financial transactions covered therein into—Imperial and Local only. But a volume of the same series after 1908 curiously enough groups the accounts not under Imperial and Local but under (1) Imperial, and (2) Provincial, while the financial Statements after 1921 cover only the Imperial Transactions. Nothing is more confusing to a beginner than the entrance of the new, and the exit of the old, categories of accounts.¹ The

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

natural question that he will ask is, how did these different categories evolve, and how are they related to one another ?

In the present study an endeavour is made to explain the rise and growth of one of them, namely, the "Provincial." But in order that there may be no difficulty in following the argument it is deemed advisable to preface this study with an outline defining its subject-matter and indicating the interrelations of the parts into which it is divided. To facilitate a thorough understanding of the subject the study is divided into four parts, *each* one dealing with the Origin, Development and Organization of Provincial Finance and the final form in which it was cast by the constitutional changes of 1919. In Part I a somewhat thorny, untrodden and yet necessary ground has been covered in order to give a complete idea of the origin of Provincial Finance. While due homage is paid to the adage which requires students of the present to study the past, nothing more than the past of the present has been dealt with. In Chapter I, Part I, an attempt is made to present a picture of the system of Finance as it existed before the inauguration of the Provincial Finance and to state the causes that called for a change in its organization. In Chapter II a rival system of Finance proposed during the period of reconstruction is brought to light and shown why it failed of general acceptance. Chapter III is devoted to the discussion of a plan which was a compromise between the existing system and its rival, and the circumstances which forced its reception.

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

to 1882 only, has taken this feature as a norm by which to mark off the different stages in the growth of Provincial Finance from one to another. Consequently, each quinquennial period to him becomes a stage, and in his hands the history of Provincial Finance falls into as many stages as the quinquenniums into which it can be divided. It may, however, be submitted that if every revision had changed the fundamentals of Provincial Finance, such an arrangement would not have been illogical. But as a matter of fact, Provincial Finance did not change its hue at every revision. What the revisions did was to temper the wind to the shorn lamb. If the history of the development of Provincial Finance is to be divided into stages according to the changes in the fundamental basis thereof, then emphasis has to be laid on features altogether different in character. Writers on the theory of Public Finance seem to conceive the subject as though it were primarily a matter of equity in taxation and economy in expenditure. But to a Chancellor of the Exchequer finance is eminently practical with a problem to solve, namely, how to bring about an equilibrium in the Budget. If we scan the history of Provincial Finance in British India with a view to discover the method of meeting the problem of equilibrium in Provincial Budgets and the changes introduced in it from time to time, we shall find that Provincial Finance has evolved through three distinct stages, each with its own mode of supply, namely, Assignments, Assigned Revenues and Shared Revenues. Consequently, instead of following the mechanical plan of Justice Ranade, it is believed to be more logical and instructive to divide the stages in the growth of Provincial finance according to the method of supply to the Provincial Governments adopted by the Government of India. Consequently, Part II, which deals with the Development of Provincial Finance, is divided into three Chapters : (1) Budget by Assignment, (2) Budget by Assigned Revenues, and (3) Budget by Shared Revenues.

This discussion of the Origin and Development of Provincial Finance is followed in Part III by an examination of its Organization. Chapter VII in Part III is devoted to the analysis of the hitherto neglected rules of limitations on the financial powers of Provincial

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

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

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

it more clearly, the decentralization of 1855 was the decentralization of *Indian* Finance resulting in—

(I) the separation of Local from Imperial Finance.

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

(II) the separation of Provincial from Imperial Finance. And the decentralization commencing from 1882 is the decentralization of *Provincial* Finance resulting in—

(III) the separation of Local from Provincial Finance.

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

PART I
PROVINCIAL FINANCE : ITS ORIGIN
CHAPTER I
THE IMPERIAL SYSTEM
ITS GROWTH AND ITS BREAKDOWN

The Imperial system of Government in India dates from the year 1833.

Of the two chief motives which led Parliament to establish it, one was to replace the existing multiplicity in the systems of justice and police by a uniform system of the same, common as far as possible to the whole of India with its varieties classified and systematized. Under the existing system then prevailing such multiplicity was inevitable, for not only the civil and military government and the ordering and management of the revenues of each of the three Presidencies, Bengal,¹ Madras,² and Bombay,³ were vested in their respective Governors in Council, but each Governor in Council was also empowered to make and issue such rules, ordinances and regulations for the good order and civil government of the territories he individually commanded, provided that they were just and reasonable and not repugnant to the laws of the British realm. To the codes of law promulgated by these authorities must be added the whole body of English Statute law introduced in India so far as it was applicable, by the charter of George I in 1726 and such other English Acts subsequent to that date as were expressly extended to particular parts of the country.

The work of administering such a diverse body of laws proved so embarrassing that it was the view of the supreme Court of Calcutta that

“no one person can pronounce an opinion or form a judgment... upon any disputed right of persons, respecting which doubt and confusion may not be raised by those who may choose to call it in question; for very few of the public or persons

¹ 13 Geo. III, c. 63. s. 36.

² 39 and 40 Geo. III, c. 79, s. 11.

³ 47 Geo. III, Sess. 2, c. 68, s. 3.

in office at home, not even the Law Officers, can be expected to have so comprehensive and clear a view of the Indian system of law, as to know readily and familiarly the bearings of each part of it on the rest.”¹

The other motive was to create a strong central government to deal effectively with the European settlers in the country. It is to be noted that if the native population suffered under the uncertainties of law, the British population lived under the most galling restrictions. The revelations of oppressions by Englishmen practised, in the early days of British Rule, contained in the report of the Secret Committee of the House of Commons appointed in 1771 to inquire into the affairs of the East India Company, were followed by very stringent laws governing the entry and residence of private British subjects in India. No British subject of European birth was allowed to reside in India beyond 10 miles from any one of the principal settlements without having previously obtained a special license from the Company or the Governor-General of India or the Governor of the principal settlement in question.² The Court of Directors of the Company, subject to revision of the Board of Control,³ were empowered to refuse such licenses⁴ and the Governments in India were strictly enjoined not to sanction the residence of British subjects on their own authorities except under special circumstances⁵ and were authorized, in cases they deemed proper, to declare licenses otherwise valid as void.⁶ Counterfeiting licenses⁷ and unlicensed residence⁸ were made crimes punishable with fine or imprisonment; and persons who were dismissed from, and who had resigned service, were declared guilty of illicit trade if they lingered beyond the 10-mile limit after their time had expired.⁹ Unlicensed British subjects were made liable to be deported,¹⁰ and such as were licensed were required to register themselves in the court of the district in which they resided.¹¹ Subjected as they were to the regulations of the Local Government¹² they were made amenable to justice in India as well as in Great Britain for all illegal acts done in British

¹ Quoted in Herbert Cowell's *The History of the Constitution of Courts and Legislative Authorities in India*, Calcutta.

² 33 Geo III, c. 52, s. 98.

³ *Ibid.*, s. 38.

⁴ *Ibid.*, s. 33.

⁵ *Ibid.*, s. 37.

⁶ 53 Geo. III, c. 155, s. 36.

⁷ *Ibid.*, s. 120.

⁸ 33 Geo. III, c. 52, s. 131.

⁹ *Ibid.*, s. 134.

¹⁰ 53 Geo III, c. 155, s. 104.

¹¹ *Ibid.*, s. 108.

¹² *Ibid.*, s. 35.

India,¹ or in Native States.² To render them impotent to cause complications, they were not allowed to lend money to or be concerned in raising any for native princes³ or foreign companies or foreign European merchants. Similarly to protect the natives from their oppression they were forbidden to lend money to the latter at a rate of interest exceeding 12 per cent. per annum on penalty of forfeiting for every offence treble the value,⁴ and they were placed under the jurisdiction of the Justices of the Peace in all cases involving assault or trespass⁵ on, and small debts⁶ due to, the natives of India. Moreover, every British subject of European birth was required to register in the office of his district the name, etc., of his native stewards, agents, and partners,⁷ on penalty of being disentitled to recover or receive any sum or sums of money by reason of the joint concern or to compel an account thereof by any suit in law or equity in any court within the provinces.⁸

The ruling race had long chafed at these restrictions, under which it was placed, without much avail. They were evidently aimed at keeping out an element dangerous to the stability of the Indian Empire, but, as time went on, and as the Indian Empire was consolidated by successive victories over the native princes, there was raised against these restrictions such a storm of indignant criticism that even those who had acquiesced in their virtue were forced to admit that they had outlived their purpose. While the British Parliament could not help abiding by the sentiments of the time, it refused to disregard the consequences which it thought would inevitably attend upon the free ingress of British subjects of European birth under the then existing system of government. It realized that a harmonious treatment of the immigrants and an effective control over them was absolutely essential. Parliament was afraid that the different governments armed as they were with co-equal and independent powers of legislation and administration by exercising these powers with regard to the immigrants entering their respective territories, with different views and according to inconsistent principles might integrate the whole mass of them into a disaffected body difficult to be dealt with. Besides the

¹ 24 Geo. III, c. 25, s. 44.

² 26 Geo. III, c. 57, s. 67.

³ 37 Geo. III, c. 142, s. 28.

⁴ 13 Geo. III, c. 63, s. 30.

⁵ 53 Geo. III, c. 155, s. 105.

⁶ *Ibid.*, s. 106.

⁷ 21 Geo. III, c. 70, s. 13.

⁸ *Ibid.*, s. 16

necessity of a harmonious treatment based on uniform principles, the fears of Parliament that the ingress of British immigrants would result in the revival of oppression on the natives were not completely allayed. As its recrudescence was felt to be a likely event, Parliament desired to subject them to a strong and uniform central control, so that the offender in one jurisdiction might not be able to find an asylum in another. Thus, whether considered from the standpoint of bringing about uniformity of laws or securing stringency of control over elements subversive of order, the then existing system of government with its divided jurisdiction was ill-suited for the purpose held in view. An all-powerful Central Government legislating for and controlling the affairs of India as a whole was deemed to be the only solution for the emergency. Accordingly there came to be enacted in 1833 that

“the Governor-General in Council (at Fort William in Bengal) shall have power to make laws and regulations for repealing, amending, or altering any laws or regulations, whatever, now in force or hereafter to be in force in the said territories or any part thereof, and to make laws and regulations for all persons, whether British or native, foreigners or others, and for all Courts of Justice, whether established by His Majesty’s Charters or otherwise and the jurisdictions thereof, and for all places and every part of the said territory, and for all servants of the said Company within the dominions of princes and states in alliance with the said Company. . . . ;”¹

A Central government was thus created by vesting the legislative power exclusively in the Governor-General of India in Council. But it could not have been all-powerful had the two Presidencies of Madras and Bombay remained as heretofore invested, by law, with the civil and military government of their respective territories. On the other hand, if Parliament had stopped short of divesting them, there would have ensued the possibility of a conflict between these governing authorities and the sole legislative authority newly created. Being responsible for peace, order and good government, the former could have refused to govern according to laws made by the latter, and all the gain expected to arise from the institution of a central and strong government would have been lost. To eliminate this element of weakness in the Indian polity

¹ Sec. 43 of 3 and 4 Will. IV, c. 85, an Act for effecting an arrangement with the East India Company, and for the better government of His Majesty’s Indian territories.

newly established, Parliament proceeded to divest the presidencies of Bombay and Madras of the high status which they hitherto occupied as *responsible* governments, so that according to the new Constitution

“.....the Executive Government of each of the several Presidencies (was to be) *administered* by (not vested in as heretofore) a Governor and three Councillors”¹

While

“.....the Superintendence, Direction, and Control of the whole civil and military government of all the.....territories and Revenues in India (was) vested in a Governor General and councillors styled the Governor-General of India in Council.”²

Thus came to be established in India the Imperial system of government. It is true that long before its establishment the Government of Bengal³ had the supreme power, not only of superintending and controlling the government and management of the Presidencies of Madras and Bombay in the matter of commencing hostilities, or declaring or making war against any Indian prince or power, or for negotiating or concluding any treaty of peace or other treaty with them, except in case of emergency, but it also possessed by a later enactment the power of superintendence in all such points as related to the collection or application of revenues, or to the forces employed, or to the civil or military government of the said presidencies.⁴ But it must not be supposed, as is often done, that before 1833 the two Presidencies were in any real sense subordinate to Bengal in their domestic affairs. The fact that Madras and Bombay were required constantly and diligently to transmit to the Government of Bengal true and exact copies of all orders and resolutions and their acts in Council, and were enjoined to pay due obedience to the orders of the Government of Bengal, must not be construed to mean any subordination in their internal affairs. For, barring the extra territorial authority vested in the Government of Bengal, it must be borne in mind that,

¹ Sec. 43 of 3 and 4 Will. IV, c. 85, an Act for effecting an arrangement with the East India Company, and for the better government of His Majesty's Indian territories.

² *Ibid.*, s. 56. By sec. 57 power was given to reduce the number of councillors at the Presidencies or suspend them altogether, leaving the Executive Government at the Presidency to be carried on by a Governor alone. This power was exercised in 1833 by reducing the executive councillors at Bombay and Madras from three to two respectively.

³ and 4 Will. IV, c. 85, s. 39

⁴ 13 Geo. III, c. 52, s. 40.

equally with Bengal,¹ the Governments of Madras and Bombay were *vested each*² with the civil and military government and also with the ordering and management of all territorial acquisitions and their revenues. Along with the Government of Bengal they possessed as stated before co-equal and independent powers of legislation within their respective jurisdictions. A truer view therefore seems to be that they forwarded the copies of their proceedings to the Government of Bengal for information rather than for orders. At any rate, such seems to have been the view taken by the Government of Bengal itself, for, though it had the power to issue orders and compel obedience to them it had in practice confined its supervision and control “to pointing out an irregularity and requesting that it be not repeated.” More than this was thought inadvisable³ and it is doubtful⁴ whether it would have been constitutional.

The Imperial system of Government was necessarily accompanied by the Imperial system of Finance. Before the inauguration of the Imperial system of Administration the several Presidencies were like separate clocks each with its own mainspring in itself. Each possessed the powers of sovereignty, such as the legislative, the penal, and the taxing powers. They were independent in their finance. Each was responsible for the maintenance of services essential for peace, order and good government within its jurisdiction and was free to find money by altering or levying taxation or borrowing on credit to meet its obligations. For their ways and means they often drew upon the resources of one another, not, however, because their exchequers were not distinct, but because they were parts of a common exchequer belonging to the East India Company. All this was changed by the Act of 1833, which vested the revenues and the government of the different territories in the Governor-General of India in Council. The revenues and the services became by law the revenues and the services of the Government of India. The provinces became the collecting and the spending agencies of the Government of India. They ceased to levy any new taxes or to collect the old ones

¹ 13 Geo. III, c. 63, s. 7.

² 33 Geo. III, c. 52, s. 24.

³ Of. Min. on the Constitution of the Indian Government by the Governor-General, Lord William Bentinck, dated September 14, 1831. Also Memorandum *re* the same by the Secretary to the Government of Bengal accompanying the despatch of Lord Canning dated December 9, 1859, published in H. of C. Return 307 of 1861.

⁴ Cf. the despatch of the Court of Directors to the Government of Bengal No. 44 dated December 10, 1834, *original* draft in the India Office Records.

in their own name. In like manner the services they administered became a charge of the Government of India, which distributed among the various provinces sums from the consolidated fund for the maintenance of the services. It was by law provided that without the previous sanction of the Government of India the provinces were not to spend the fund allowed to them in creating any new office or granting any salary, gratuity, or allowance.¹ The public debt was no longer a charge upon the revenues of any particular Presidency alone, nor did there remain any question of primary or secondary liability as between the revenues of the other Presidencies. All the provincial debts became the debts of the Government of India and were charged to the revenues of India as a whole. In short, the financial system which was roughly analogous to the system of separation of sources and contributions from the yield was changed into a system of aggregation of sources and distribution of the yield; for, as observed in a Government Resolution by virtue of the Act of 1833,

“British India, though for the sake of convenience subdivided into Presidencies under separate locally controlled governments, (became) in reality one sole grand Power in dependence on Great Britain, having undivided interests, a single exchequer, and controlled in all essential and general principles by one Government—the Governor-General in Council.....The entire resources of India (were) applicable to one purpose only, the discharge of its engagements and those connected with its management in England, and to whatever section of British India funds (were) wanting, funds (were) supplied, as a matter of course, without any reference to the particular source from which they were derived.”²

So comprehensive did the system of Imperial Finance become in time that when in 1858 the Crown took over from the Company the government of India it was found that

“no province had any separate power of legislation, any separate financial resources, or practically any power of creating or modifying any appointments in the public service; and the references to the Government of India which this last restriction involved gave that Government the opportunity of interference with all the details of provincial administration.”³

¹ 3 and 4 Will. IV, c. 85, s. 59.

² Government of India, Financial Department Resolution, dated November 22, 1843.

³ *Report of the Royal Commission on Decentralization in British India*, p. 24.

Whatever may have been the merits of the Imperial system of Government from the military, political, legislative, or administrative points of view, it is a melancholy fact that as a system of finance it proved unequal to the strain imposed upon it. From its very start it suffered from the fatal disease of financial inadequacy, and it was only occasionally that the efforts of the Finance Ministers were successful in restoring an equilibrium and staving off the hour of crisis. How chronic the deficits were may be seen from the following figures :—¹

INSUFFICIENCY OF IMPERIAL FINANCES

Year	Surplus	Deficit	Year	Surplus	Deficit
	£	£		£	£
1834-35	...	194,477	1846-47	...	971,322
35-36	1,441,513	...	47-48	...	1,911,986
36-37	1,248,224	...	48-49	...	1,473,225
37-38	780,318	...	49-50	354,187	...
38-39	...	381,787	50-51	415,443	...
39-40	...	2,138,713	51-52	531,265	...
40-41	...	1,754,852	52-53	424,257	...
41-42	...	1,771,603	53-54	...	2,044,117
42-43	...	1,346,011	54-55	...	1,707,364
43-44	...	1,440,259	55-56	...	972,791
44-45	...	743,893	56-57	...	143,597
45-46	...	1,496,865	57-58	...	7,864,222

Anyone who ponders upon this pitiable story of Indian Finance as revealed by these deficits can hardly fail to wonder with Disraeli who remarked in the House of Commons that—

“able as has ever been the administration of India, considerable and distinguished as have been the men whom that administration had produced, and numerous as have been the great Captains, the clever diplomatists, and able administrators of large districts with whom the Government has abounded, the v state of the finances of India has always been involved in perplexity, and India that has produced so many great men, seems never to have produced a Chancellor of the Exchequer.”²

¹ From the Financial Statement of British India for 1860-1 by Mr. Wilson. H. of C Return 33 of 1860, p. 100.

² *Sir Charles Woods' Administration*, by West, pp. 65-6.

The causes of this collapse, however, are not far to seek. The inadequacy of Indian Finances is mainly to be ascribed to an unsound fiscal policy. The policy was unsound for various reasons. In matters of state economy it is usual to argue that the expenditure to be incurred should determine the magnitude of revenue to be raised. But experience has shown that this stock maxim has proved ruinous wherever its limitations have failed to receive their due weight. It cannot be too often said that the growing expenditure of the State can only be sustained from the growing wealth of the society. Nor can it be too strongly emphasized that the test of sound finance does not merely consist in being capable of raising the requisite amount of revenue. It must be remembered that the *mode* of raising the revenue is an aspect of the question which is fraught with tremendous consequences for the stability and productivity of the nation. It is too obvious to be denied that a tax system by its unequal incidence may cause social upheavals, just as by its unwise incidence on trade and industry it may impoverish society by setting out of gear its economic mechanism and technique and eventually beggar the State by impairing the productive powers of society. Wisdom therefore requires that those who are entrusted with the financial management of the State should look beyond the more immediate object of raising and spending of money, for the "hows" of finance are very important, and can be seldom neglected in practice with impunity. The wealth of society is the only patrimony on which the State can draw, and the State that damages it cannot but end in damning itself. History abounds with instances of States wrecked by the unwise neglect of these evident truths, but if an illustration be wanted in further proof thereof, the system of Imperial Finance established in India is matchless for the purpose.

The land tax was the heaviest impost of the Imperial revenue system in operation. The underlying doctrine of the tax in India has been that it is of the nature of rent paid by the cultivator to the State in virtue of the theory that the land in India has from immemorial times been regarded as the property owned by the State. The cultivator is not the proprietor, but is the occupier of the land. The land is let to him and the State is therefore justified in claiming the whole of the economic rent arising from the land. On this assumption the land tax has been imposed irrespective of the question of necessity or justice.

Besides this legal fiction of State landlordism there was also another economic principle which was taken to be the justification for the enhancement of the land revenue. There is reason to believe that the Physiocratic doctrine of *produit net* had its influence in the management and fixing of the land tax in India. We find high officials in India arguing in the early stages of the revenue management that “whether or not the principle of the French Economists of laying all the taxes on the land be.....erroneous or otherwise, it is certainly conformable to the prevalent system in India; nor is that theory supported by the French alone, but by respectable authorities in England, who contend that all taxes fall ultimately on the products of the soil, and that in advancing a different doctrine the eminent author of *The Wealth of Nations* is at variance with himself, inasmuch as his previous data lead to that conclusion.”¹ Whatever may have been the reasons for augmenting the land tax, few can deny that a heavy consolidated impost on the first exertions of any species of industry absorbing the whole or nearly the whole of its profits in ruinous and impolitic. It becomes an effectual bar to the creation of that produce on which the future exertions might be profitably employed and through the medium of which individual wealth and public revenue may be increased to an almost inconceivable extent. A land tax of this nature was sure to blast the very production of that wealth which industry would have otherwise brought into being. The land tax was so heavy that the system of tax prevailing in India might well have been called a near approach to the single tax system.²

¹ For this remarkable controversy, which has escaped even the comprehensive eye of Baden Powell, see House of Commons paper 306 of 1812-13.

² The ratio of the land revenue to the total revenues of India was as given below :—

Year	Ratio	Year	Ratio	Year	Ratio
1792-3 } to 1796-7 }	50.33	1817-8 } to 1821-2 }	66.17	1842-3 } to 1846-7 }	55.85
1797-8- } to 1801-2 }	42.02	1822-3 } to 1826-7 }	61.83	1847-8 } to 1851-2 }	56.06
1802-3 } to 1806-7 }	31.99	1827-8 } to 1831-2 }	60.90	1852-3 } to 1855-6 }	55.40
1807-8 } to 1811-2 }	31.68	1832-3 } to 1836-7 }	57.00	Average, for 64 years }	54.07
1812-3 } to 1816-7 }	52.33	1837-8 } to 1841-2 }	59.05		