

and extravagant in the last few years lest their expenditure should shrink below the standard and leave large margins to be cancelled by the Government of India on revision of their settlements. No Local Government could be expected to put into execution any carefully matured and well-thought-out scheme of improvement within the short span of a quinquennium. All that it could do was to spend the first two or three years in working out a scheme and utilize the last two or three years in rushing it through, as was done by most of the Provinces. This tendency to undertake such schemes, the only merit of which was that they could be carried through before the revision, and mainly in order to reach the standard expenditure, was a direct consequence of the quinquennial budget system. This is by no means an a priori conclusion. A glance at the annual surplus of the provinces will indicate how they tend to rise in the beginning of the quinquennium and fall at the end of it. To obviate these evils of parsimony and extravagance the only remedy was to do away with the principle of quinquennial revision, and this the Government of India courageously undertook to effect. The right to revise was a much cherished right, and the Government of India had not failed to exercise it in the teeth of all opposition from the Provinces. It was abandoned only because its exercise was deemed to be mischievous.

Taking the year 1903-4 as the normal one, the Government of India decided to revise the provincial settlements of all the different Provinces. The idea was to adjust the revenues between the Imperial and the Provincial Governments on the basis of the total expenditure they respectively controlled. It was found that the aggregate provincial expenditure represented less than one-fourth of the whole, while the Imperial expenditure, which included Army and Home Charges, aggregated in excess of three-fourths. These proportions of expenditure were taken as the basis of the division of revenue between the Imperial and the Provincial, and the following standard shares of revenue and expenditure under the joint heads were agreed upon :—

	Imperial	Provincial
Bengal, U.P., Bombay, Madras	$\frac{3}{4}$	$\frac{1}{4}$
Punjab, Burma	$\frac{5}{8}$	$\frac{3}{8}$
C.P., Assam	$\frac{1}{2}$	$\frac{1}{2}$

The reasons for adopting different standard rates of division in the case of the Punjab, Burma, C.P. and Assam was to give the backward provinces opportunities of development in the same proportion as lay within the reach of the advanced provinces.

Of the settlements made in 1904-5 the Government of India declared that those made with the Provinces of Bengal, Madras, Assam and U.P. were to be permanent and not subject to revision in future, except when it was found that the financial results were unfair to a Province or to others by comparison, or to the Government of India when it was confronted by an extraordinary calamity. Owing to this proviso their settlements were termed quasi-permanent. To obviate the recrudescence of unfairness during the currency of the settlements the Government of India felt it necessary to enter certain modifications in the standard ratio of division of the joint-heads of revenue and expenditure with regard to the Provinces brought under the quasi-permanent settlement. They were as follows :—

Revenue	Provincial Share			Expenditure	Provincial Share		
	Bengal	Madras	U.P.		Bengal	Madras	U.P.
Excise ...	$\frac{7}{16}$	...	...	Excise ...	$\frac{7}{16}$	...	...
Stamps ...	$\frac{1}{2}$	$\frac{1}{2}$	$\frac{1}{2}$	Stamps ...	$\frac{1}{2}$	$\frac{1}{2}$	$\frac{1}{2}$
Registration ...	Wholly	Wholly	...	Registration ...	Wholly	...	...
Irrigation ...	...	...	Wholly	Land Revenue ...	Wholly	Wholly	Wholly

Compiled from the Financial Statement of the Government of India for 1904-5, p. 57.

Besides these modifications the Government of india gave them the following grants :—

Bengal	Madras	United Provinces
1. Addition of 4 lakhs to the assessment to improve the pay of Ministerial establishments.	1. Grant of 20 lakhs for Survey and settlements.	1. Irrigation revenue guaranteed up to 40 lakhs.
2. Further addition not exceeding 2½ lakhs for for strengthening the staff of Deputy Collector.	2. Grant of Rs. 75,000 a year recurring for relief of certain local bodies.	2. Grant of 2½ lakhs a year in relief of local bodies.
	3. Rs. 50,000 a year for agricultural experiment.	3. Half a lakh a year to reform District Board Finance.
	4. Undertaking to bear charges for reorganizing district administration.	

Compiled from the same Financial Statement of the Government of India, p. 67.

The standard revenues and expenditure of the quasi-permanently settled provinces, after taking into consideration the alterations in their respective shares in the joint revenues, were as follows :—

STANDARD REVENUES AND EXPENDITURE

(in thousands of rupees).

Province	Expenditure	Revenue		
		Revenues	Assignments	Total
Madras	3,50,48	2,90,82	5,966	3,50,48
Bengal	4,98,87	4,49,84	4,903	4,98,87
U.P.	3,66,64	3,62,64	400	3,66,64
Assam	72,07	60,07	1,200	72,07

The gain to the Imperial treasury on the revenue side brought about by the revision of the quasi-permanently settled Provinces was Rs. 2,06,000. But the revision also over-burdened the Imperial Government with a total charge of Rs. 36,000 hitherto borne by the Provincial Budget. Thus its net gain was only Rs. 1,70,000 a year on the normal.

As in the beginning of the scheme of Provincial Budgets, the government of India thought it advisable to make to the quasi-permanently settled Provinces the following initial grants so as to give them a fair start:—

To Bengal,	Rs. 50 lakhs. (Exclusive of 50 lakhs for Calcutta University.)
To Madras,	Rs. 50 lakhs. (Inclusive of 20 lakhs for survey settlement.)
To U.P.,	Rs. 30 lakhs. (Exclusive of 1¼ lakhs to compensate forexpenditure on the purchase of encumbered estates.)
To Assam,	Rs. 20 lakhs.

Of the remaining Provinces, Bombay and the Punjab were the next to obtain quasi-permanent settlements with effect from 1905-6.

In recasting their settlements the Government of India departed a little from the standard rate of division as applied to the Provinces quasi-permanently settled in 1904-5. With certain exceptions mentioned below the joint heads of revenue and expenditure were

divided half and half, including Irrigation in Bombay, instead of three-fourths and one-fourth between the Imperial and the Provincial. The exceptions to this rule were the following :—

Revenue Heads of Account	Provincial Share		Expenditure Heads of Account	Provincial Share	
	Bombay	Punjab		Bombay	Punjab
Land Revenue	Guaranteed Up to 189½ lakhs	$\frac{3}{8}$	Land Revenue	Wholly	Wholly
Registration	Wholly	Wholly	...	...	...
Irrigation	$\frac{1}{2}$	$\frac{3}{8}$ Guaranteed up to 28 lakhs			

Compiled from the Financial Statement of the Government of India

The standard revenue and expenditure of these two provinces under the quasi-permanent settlement was as follows :—

Province	Expenditure	Revenue		
		Revenues	Fixed Assignments	Total
	Rs.	Rs.	Rs.	Rs.
Bombay	4,91,75,000	4,48,98,000	42,77,000	4,91,75,000
Punjab	2,49,50,000	2,46,50,000	3,00,000	2,49,50,000

The raising of the shares and the fixing of assignments on a liberal scale with respect to these famine and plague-stricken Provinces left the Imperial Government a loser on the transaction. On the basis of the new standard of revenues the Government of India lost Rs. 5,95,000 on the two Provinces together. The corresponding increase in the provincial shares of the joint heads of expenditure, however, lessened the Imperial expenditure by Rs. 2,21,000 a year. On the whole, therefore, the Imperial Government sacrificed a normal gain of Rs. 3,74,000 to give permanency and stability to the finances of these two Provinces. This was over and above the initial grant of Rs. 50,00,000 to each of them in order to enable them to set their sails in smooth waters.

A year after, the settlement of the Central Provinces was made quasi-permanent with effect from April 1, 1906. The shares in the joint heads of revenue and expenditure were raised, as they were in the case of Bombay and the Punjab, and particularly because of the addition of Berar, which was hitherto administered directly

by the Imperial Government, from three-fourths and one-fourth to one-half between the Imperial and the Provincial, the share in the land revenue being guaranteed up to 82½ lakhs. The only exception to this rule of even division was the Registration revenue, which was made wholly provincial. To balance the revenue with the expenditure an assignment of Rs. 27,07,007 a year was fixed and an initial grant of Rs. 30,00,000 was given for a fair start.

Along with the settlement of the Central Provinces it became necessary to reorganize the budgets of the quasi-permanently settled Provinces of Bengal and Assam owing to certain administrative changes. The two Provinces were reconstituted into (1) Bengal and (2) Eastern Bengal and Assam. In the revision of its financial settlement the new Province of Bengal was accorded the same proportionate share in the joint revenues as were granted to Bombay and the Punjab—namely, a share of a half in all the joint heads. Registration and that portion of the Land Revenue which was derived from Government Estates under the direct management of the Imperial Government were, however, made wholly provincial. In lieu of this favoured treatment the fixed assignment of the Province was reduced from 49.03 lakhs to 5.72 lakhs.

In the new Province of Eastern Bengal and Assam the principle of even distribution was applied to all joint heads of revenue and expenditure with the exception of Registration, which was made wholly provincial. This enhancement of shares so greatly augmented the resource side of the Provincial Budget that the balance had to be restored by a negative operation of a fixed adjusting assignment from the Provincial to the Imperial funds. The following figures show the standard expenditure and the standard revenue for the three provinces brought under the quasi-permanent settlements :—

Province	Expenditure	Revenue		
		Revenues	Assignments	Total
	Rs.	Rs.	Rs.	Rs.
C.P. 	1,76,43,000	1,49,36,000	27,07,000	1,76,43,000
Eastern Bengal and Assam	2,12,19,000	2,18,42,000	6,23,000	2,12,19,000
Bengal 	4,72,73,000	4,67,01,000	5,72,000	4,72,73,000

Some modifications were later on introduced in the settlement of the Province, so that a positive adjustment had to be made by an assignment from the Imperial to the Provincial of Rs. 60,000 a year.

The only Province which was outside the pale of the quasi permanent system was Burma. The last quinquennial settlement made with it in 1902-3 having expired, the Government of India decided to bring it in uniformity with the other Provinces by giving it a quasi-permanent settlement from April 1, 1907. In a spirit of perfect impartiality it was also given an even share in the principal joint heads of revenue and expenditure, salt being imperialized as in other provinces. It was given an adjusting assignment of Rs. 90,68,000 a year to cover the deficits in its standard expenditure and an initial grant of Rs. 50,00,000.

By the year 1907 all the Provinces were brought within the pale of the quasi-permanent settlement, and we would have expected the scheme of Provincial Finance to run its course undisturbed by any further changes. But it so turned out, as must have been noticed, that the quasi-permanent settlements made with Madras and U.P. in 1904 had become a little unfair to them in comparison with the terms offered to the Provinces subsequently dealt with. To remove this ground of injustice, which was one of those recognized for subjecting the quasi-permanent settlements to revision, the shares of the two Provinces in the joint heads were raised with effect from April 1, 1907, to one-half, with the following exceptions :—

Madras		United Provinces	
Revenue		Revenue	
1.	Registration. Wholly Provincial,	1.	Land Revenue. 3/8 Provincial. Minimum of 240 lakhs guaranteed.
2.	Land revenue. Minimum receipt of 308 lakhs guaranteed if the provincial share fell below that amount.	2.	Irrigation. Minimum receipt of 60 lakhs from major irrigation works guaranteed, if the provincial share fell below that amount.
Expenditure			
1.	Registration. Wholly provincial.		
2.	Land Revenue. Wholly provincial.		

The fixed assignments to cover the difference between the excess of standard expenditure over standard revenue were :—

To Madras	...	Rs. 22,57,000
To U.P.	...	Rs. 13,89,000

Thus the scheme of Provincial Finance in British India had advanced by gradual but distinct steps of assignment budgets, assigned revenue budgets and shared revenue budgets to a stage the terms of which were regarded by the parties concerned as

sufficiently final. How far their expectations were fulfilled may be judged from the annual surpluses and deficits in Provincial Finance and from the range in their deviations as indicated in the following table :—

PROVINCIAL SURPLUSES AND DEFICITS

Province	1904-5	1905-6	1906-7	1907-8	1908-9	1909-10	1910-11	1911-12
	Rs.	Rs.	Rs.	Rs.	Rs.	Rs.	Rs.	Rs.
C.P.* ...	—701000	3235000	1750607	—930617	—3097865	721755	280556	1214573
Burma ...	—1591796	—2613890	1890516	—3129590	—2060678	2515371	1900297	—1260040
Assam† ...	—269316	—3720027	—200140	—2596682	—2357687	549270	5539698	5218802
Bengal ...	—1252818	—1952312	—1877455	—2256994	—1330371	3274065	3960612	6296233
U.P. ...	—869099	—2879192	795600	—3587066	1007260	2045221	3635904	144240
Punjab ...	4794387	—2796052	—661214	—2408818	—1576981	1300559	4199121	3398055
Madras ...	—1402344	220328	1217745	—44992	2025109	1266326	2316383	2938502
Bombay ...	4396000	—42892	1752202	—308925	—2618926	7137996	7585460	—541411

* Includes Berar since 1906.

† Eastern Bengal and Assam since 1906.

Compiled from the Annual Finance and Revenue Accounts of the Government of India.

In judging of these results account must also be taken of the various benefactions made by the Government of India to the Provinces by way of grants-in-aid during the same period. These grants were as follows :—

IMPERIAL GRANTS-IN-AID TO THE PROVINCES

Province	1904-5	1905-6	1906-7	1907-8	1908-9	1909-10	1910-11	1911-12
	Rs.	Rs.	Rs.	Rs.	Rs.	Rs.	Rs.	Rs.
C.P.* ...	2853710	6957793	110500	2752010	2903668	3588270	3465500	2080845
Burma ...	567500	1845000	7219000	682000	215253	1820952	4232742	3605164
Assam ...	...	3362916	327294	280030	2358947	4464435	4608965	6100732
Bengal ...	24794	4806984	475548	1362634	4157393	5753692	6137013	11131276
U.P. ...	136600	4036307	7641697	9879667	8770345	1624329	4513729	3136107
Punjab ...	7526436	2467579	4209531	5541529	6037990	5839014	9592844	3101681
Madras ...	700946	4430714	9980400	9473304	704885	612941	3691426	5008889
Bombay ...	10312928	3427325	4024512	4574284	5726162	5797603	12009360	4935159
Total ...	22122914	31334618	34982982	34543458	30874643	29502286	15475360	39099853

* Includes Berar since 1906.

Compiled from the Annual Finance and Revenue Accounts of the Government of India.

But in taking account of these benefactions it must not be supposed that, barring a solitary case or two, they were necessary in order to preserve the solvency of Provincial finance as it was defined by the terms of the settlement made with the different provinces. Far from being insufficient, the revenues settled upon the different Provinces proved quite ample for their needs if we take the last years, and they are the most typical years, into consideration.

Permanent Settlements of 1912

Soon after the series of quasi-permanent settlements were concluded with the different provinces, the subject of Provincial and

Central Finance in British India among others of a like nature was investigated by the Royal Commission on Decentralization. In its Report issued in 1909 the existing method of allocating revenue and charges between the Imperial and Provincial Governments was upheld in principle. Of the many-adverse criticisms passed by witnesses who appeared before the Commission only two were regarded by it as worthy of consideration : (1) The adjusting assignment and (2) Grants-in-aid, or doles as they were cynically termed. It was urged, and with some truth, that the adjusting assignments impaired the elasticity in provincial revenues by reason of the fact that while charges grew, that part of the provincial resource, which was made up by assignments, and in some cases it formed quite an appreciable part, remained unaltered. Secondly, it was argued that doles were demoralizing and that it would be better to replace them by shares in growing revenue. The Commission seems to have been completely impressed by the disadvantages of large adjusting assignments, but it demurred, and rightly so, to the criticisms with regard to the doles. Every one extolled the benefits of decentralization to the Provinces, but few realized the anxieties that it involved to the Government of India. It must have been clear that by the process of decentralization the Government of India had given the Provinces more or less complete freedom in distributing their funds in any way they liked upon the services delegated to their management, while it had remained responsible for their efficient upkeep by the provisions of the law which governed its constitution. But the freedom which the provinces had obtained in carrying on the financial management of the services made over to their particular control, involved the possibility of their fostering certain services deemed to be of immediate utility to the people of the Provinces, and neglecting others the utility of which, though remote to the Provinces, was nevertheless real to the country as a whole. Neglect of nationally important services such as Education, Sanitation, Police, was especially to be avoided during periods of plague and famine. But the Government of India could not enforce distribution of provincial funds on such services; for one of the vital conditions of Provincial Finance was freedom of appropriation on provincialized services, which were not distinguished into obligatory and optional as is the case in the continental system of local finance.

The Government of India was indeed not as powerless as the Central Government in England which, as is well known, cannot rectify cases of neglect by local authorities without resort to a writ of *mandamus*. But the way to bring a recalcitrant province to order, if easier, was not pleasant. For, the only way to mend such a situation was to end it by suspending the operation of Provincial finance. Rather than resort to such a grave measure the Government of India happily hit upon grants-in-aid of particular services as a powerful and well-tried¹ corrective to the negligence of the Province, and require it to maintain a "national minimum" in those services which it regarded as onerous rather than beneficial.² Convinced of the virtue of grants-in-aid as a brake on decentralization degenerating into disintegration, the Commission only recommended that measures be taken to give Provincial Finance the greatest elasticity possible by diminishing the assignments to the smallest magnitude possible.

Following the recommendations of the Commission the Government of India decided to make certain modifications in the existing allocation of revenue and charges and to make the quasi-permanent settlements permanent settlements from the year 1912. The permanent settlements did not differ from the quasi-permanent settlements which they superseded in any material point so far as the principle of allocation was concerned. The only point of difference between them in that respect was a partial replacement of the fixed adjusting assignments by increased shares in the following joint heads of revenue and expenditure :—

Modifications in Shares			
Revenues		Expenditure	
Heads of Account	Provincial Share	Heads of Account	Provincial Share
1. Land Revenue including the portion credited to Irrigation.	$\frac{5}{8}$ to Burma $\frac{1}{2}$ Punjab	1. Land Revenue	$\frac{5}{8}$ Burma $\frac{1}{2}$ Punjab
2. Excise	Wholly in Eastern Bengal and Assam, Bombay. In C.P., Bengal and U.P., $\frac{3}{4}$	2. Excise	Same as in revenue column.
Assessed Taxes			
3. (P.W.D.)	$\frac{1}{2}$	...	...
4. Forest	Wholly.	4. Forest	Wholly
5. Major Irrigation works (excluding portion of Land Revenue credited to it).	$\frac{1}{2}$ in Punjab, minimum of 4 lakhs guaranteed.	5. Major Irrigation	$\frac{1}{2}$
6. Major and Minor Irrigation.	$\frac{1}{2}$ in Bengal	6. Major and Minor Irrigation.	$\frac{1}{2}$ in Bengal

¹ It is possible that the system was borrowed from England.

² S. Webb, *Grants-in-Aid*, 1911, p. 25.

The effect of these modifications in the shares in the joint heads of revenue and expenditure was to reduce the adjusting assignments to the following figures :—

Province	Assignments in Lakhs of Rupees from Imperial to Provincial	From Provincial to Imperial
Central Provinces	21.40	...
Burma	13.12	...
Eastern Bengal and Assam	13.55	...
Bengal	...	18.40
U.P.	...	19.26
Punjab	6.77	...
Madras	...	21.43
Bombay	...	9.38

During the permanent as during the quinquennial and quasi-permanent settlements the grants-in-aid of specific services, unobjected to as they were by the Decentralization Commission, were continued to be given to the different Provinces throughout the period although, as may be seen from the following figures, in a continually diminishing magnitude :—

Special Grants-in-Aid (in rupees)

Provinces	1912-13	1913-14	1914-15	1915-16	1916-17	1917-18	1918-19
CP. ...	4790480	2643264	5138256	4407802	3795784	3817540	2726008
Burma ...	8538948	2263939	3849763	3869472	216979	—2478482	2490
Assam ...	5530991	3283011	7533878	6577619	2497861	1922252	2444730
Bengal ...	15401885	6480800	7594894	7186436	6538732	7074773	9889717
Bihar & Orissa	6379420	4761028	3526567	4278854	3262214	4235205	4179425
U.P. ...	11470603	8542279	3842624	3229924	2453969	2706164	3590530
Punjab ...	6700924	2424404	3988117	5908923	4925830	4862616	5563665
Madras ...	12277591	5066343	1697803	1220785	1099165	1483708	1577446
Bombay ...	11192723	3996729	1468837	1200254	1065964	1154725	2479510
Total ...	82283565	39461797	38640739	37880069	25856498	24778501	35453521

Compiled from the Annual Finance and Revenue Accounts of the Government of India.

It was natural that the results of the permanent settlement should have been more anxiously awaited for with great interest by the Provinces, for the permanent settlement had the potentiality of a permanent gain or a permanent loss. That their anxiety on that score could not out have been completely allayed is amply supported by the repeated surpluses that meet the eye as it passes over the following figures of annual additions to and deductions from their balances during the

period of its currency :—

PROVINCIAL SURPLUSES OR DEFICITS (IN RUPEES)

Provinces	1912-13	1913-14	1914-15	1915-16	1916-17	1917-18	1918-19
C.P. ...	5085246	1881245	—6544416	—13836	4235704	1870517	920121
Burma ...	8874174	914026	—3729808	1896621	9427702	12067708	4873587
Assam ...	3610494	—2217691	—4550789	658812	6044904	2800634	435872
Bengal ...	14705270	480842	—3967607	1028156	3708638	5280082	732237
Bihar & Orissa	7022199	—920062	—1870264	1133562	5919907	7176786	3643564
UP. ...	9588749	50704	—4611080	—973090	3427808	—2268311	3686945
Punjab ...	7411069	—692512	—3730641	—1133541	500995	—695216	1185930
Madras ...	4330275	—5298411	—1207754	318508	2571241	1042303	—972354
Bombay ...	7083281	1558566	—2639924	—951099	122434	611321	1681066

Compiled from the Annual Finance and Revenue Accounts of the Government of India.

While the condition of Provincial Finance was thus undoubtedly prosperous, the erratic movements in the provincial balances do not quite bear out the hope of orderly progress that was entertained of the permanent settlement. It should be noted, however, that the period during which the permanent settlement was current was not wholly a normal period. Part of the permanent settlement was no doubt a peace period, but it was not even as long as a quinquennium, and it should not on that account detract from the merits of a permanent settlement if it disclosed the faults of the quinquennial settlements. Most of the period covered by the permanent settlement was, however, a period of the Great War, the abnormal events of which could not have had any but disturbing effects on Provincial Finance.

Whether the permanent settlements would have been adequate for the purpose in view if sufficient length of time had been allowed for conditions to have become settled it is not given to us to say. For, from April 1, 1921, provincial Finance in British India entered on an entirely new phase. That phase of it will be dealt with in another part. Here the study of the growth of Provincial Finance as it developed stage by stage under the old phase comes to an end. But this study will not be complete until we deal with the mechanism which inter-related the finances of the Central and Provincial Governments under the old phase. But before we proceed to do so it might be of interest as well as of value that the study of the final stage in the development of Provincial Finance were to close with the following retrospect of provincial revenue and expenditure which shows, as nothing else can, the small beginnings, the large strides and the vast proportions that Provincial Finance had reached during the half century over which it had been allowed to run its course.

GROWTH OF PROVINCIAL FINANCE

Provinces	Provincial Revenues As a percentage of the total Revenues of India						Provincial Expenditure As a percentage of the total Expenditure of India					
	1871-2	1882-3	1892-3	1904-5	1912-3	1918-9	1871-2	1882-3	1892-3	1904-5	1912-3	1918-9
C.P.	.655	1.055	.863	.905	2.52	1.715	.652	1.008	.87	.984	2.19	1.685
Burma	.572	1.66	2.256	3.023	4.73	3.57	.592	1.914	2.16	3.31	4.14	3.15
Bengal	2.8	5.9	4.72	4.12	5.56	4.00	2.7	6.68	4.52	4.26	4.56	3.84
N.W.P. and Oudh	1.99	4.16	3.6	...	...	...	2.04	4.4	3.32	...	...	...
Punjab	1.66	1.59	1.888	2.08	3.96	3.11	1.55	2.165	2.03	1.83	3.47	2.81
Madras	1.595	3.32	3.3	2.88	6.27	4.75	1.61	3.24	3.4	3.09	6.1	4.53
Bombay	1.8	4.9	4.49	4.05	6.17	5.45	1.836	5.08	4.4	3.77	5.7	5.00
Assam	...	.61	.738	.597	1.38	1.00	...	.505	.617	.618	1.13	.857
U.P.	...	...	...	2.99	5.5	4.15	...	...	...	3.01	4.87	3.94
Bihar and Orissa	...	...	...	...	2.6	1.9	...	...	...	...	2.11	1.775
Total Provincial	11.11	22.8	21.75	20.4	38.6	29.2	10.8	25.00	21.3	20.8	34.3	27.6

Complied from the Annual Finance and Revenue Accounts of the Government of India.

PART III
PROVINCIAL FINANCE : ITS
MECHANISM
CHAPTER VII
THE LIMITATIONS OF PROVINCIAL FINANCE

To those who might be expected to have a knowledge of the anomaly—unparalleled in the annals of administration—involving the existence of provincial Government without there being the necessary complement of Provincial Finance, the study could not but have been of profound interest as disclosing the manner in which the anomaly created in 1833 was rectified or seemed to be rectified in 1870.¹

¹ There, however, prevails the idea that Provincial Finance existed long before 1870, But this is undoubtedly an error which may as well be corrected in this place by briefly recalling the history of financial decentralization prior to 1870. The year 1855 will always stand preeminent in the history of decentralization of Indian Finance. It is from that year that Local Finance dated its origin. It must not, however, be supposed that prior to 1855 there were no local revenues. On the contrary, there were very small funds such as Ferry Funds, Toll Funds, Cesses, etc., in existence and were spent on improvements of local utility, but the important point to note is that the balances from such funds were not carried to a separate account but as a rule merged in the general balances of the country, with the exception probably of Bengal and North-Western Provinces, where it seems that such balances were carried to separate Local Fund Accounts (cf. *Calcutta Review*, 1851, Vol. 16, pp. 464 and 466). It was by the Financial Resolution of May 11, 1855, that Local Funds were completely separated from Imperial Funds and were treated as “Deposits”—a sub-division of the Account Head “Debt” (cf. *Accountant's Manual*, by Y. Venkatramaiah, Part I, Madras, 1866, p. 79) and by the Resolution of September, 1863, Local Finance was established on a separate footing by the institution for each of the different provinces of a distinct Local Fund Budget as separate from the Imperial Budget. It so happened that in the absence of local authorities the Government of India entrusted the task of the preparation and execution of the Local Funds Budget to the respective Provincial Governments as being more in touch with local wants. It is this accident that has betrayed many into the supposition that this was essentially Provincial Finance. But nothing can be a greater blunder. What existed before 1870 was Local Finance, pure and simple, although *under* the supervision of the Provincial Government, in whose hands the Local Funds were essentially a kind of trust. The mere bringing together by the Provincial Governments of the receipts and charges pertaining to the Local Funds into a Local Fund Account for the whole Province can hardly be interpreted to mean the amount to be at their disposal—and that is the only sense in which Provincial Finance can be a reality—any more than the bringing together of the Local Rates levied in the United Kingdom in the budget of the Chancellor of the Exchequer can give an indication of its financial position. The Local Funds were not at the disposal of the Provincial Governments, for they could not be disposed of on purposes other than those which attached to them. In this sense they constituted Local Finance and not Provincial Finance. Some people mistake it for Provincial Finance probably because the term “Local Government” is used as a synonym for Provincial Government. But, while Local and Provincial Governments are often used as interchangeable terms, it must be remembered Local and Provincial Finance cannot be so used. As a matter of fact, there was a period in the history of Financial organization in India during which there was Local Finance without Local Government to be precise, and there was no Provincial Finance, even though there were Provincial Governments. It is probable that, as long as the habit of speaking of Provincial Government as Local Government continues, this confusion of ideas will not entirely vanish. While some have insisted that Provincial Finance had its being long before 1870, the Resolution of December 14, 1870, which instituted the scheme of Provincial Finance, is called “Resolution on Local Finance” as though it gave rise to Local and not Provincial Finance. Such absurdities can be avoided only by insisting upon precision of terminology.

On a purely a priori consideration of the matter, nothing could have been more natural than to suppose that the system of Provincial Finance thus established in British India was independent in its organization. Indeed it is difficult to imagine how one could emerge from the study of its origin and development without such a faith having silently grown upon him. But if Provincial Finance was independent in its organization, we should find the Provinces in possession of financial powers which are commonly associated with the functioning of independent States. For the immediate purpose of finding out whether or not Provincial Finance was an independent system of finance, we may take the freedom of budgeting and everything that is involved in it as an evidence of the existence of these powers. Independent budget powers would involve the power to determine the services which, according to the needs of the country, a good government should undertake, and to decide upon the mode of raising either by taxation or loan sufficient money to meet the expenditure upon those services. Alongside these powers the budget system entails the obligation of keeping accounts and submitting them to independent audit.

Applying these tests to the Provincial Budget, the origin and growth of which have been treated in the foregoing parts of this study, we cannot predicate a tithe of the independence which characterizes the budgets of sovereign States. On the contrary, the budget system introduced into India with regard to the different Provinces was accompanied by the most stringent limitations. They were given a budget *without its powers*, and they bore the obligations of accounts and audit just because they were left free within the limits of their budgets. Why these limitations were imposed will be explained when we come to scrutinize the ways of enlarging the scope of Provincial Finance. It must, however, be emphasized that these limitations formed an integral part of the scheme, and the stringency of the former had grown *pari passu* with the scope and proportions of the latter. In fact they defined the law of the Constitution of Provincial Budgets. A complete comprehension of the operation of Provincial Finance in British India is therefore not possible without a thorough knowledge of its rules of government. Such being the importance of these rules it cannot but be to our advantage to analyse them at this stage.

These rules were laid down on various occasions during the interval between 1870, when the scheme of Provincial Finance came into being, and 1912, when the scheme reached through an evolutionary process its final and permanent stage, in the form of Resolutions of the Government of India in the Department of Finance. The rules framed in 1870¹ were few and simple. Nor was there any necessity for a complex code to govern the operation of the very meagre budgets which were then constituted. Many supplementary rules were issued afterwards to dispose of unforeseen cases of order and procedure; but it was not till 1877² that we come across a most elaborate set of rules and regulations governing the financial transactions of the provincial Government. The Rules of 1877 were the basis of all those that were subsequently issued. With very small addenda or corrigenda they remained in force for a period of fifteen years, when they were superseded by a new series of Rules promulgated in 1892.³ But only within a short span of a quinquennium this series was replaced by another issued in 1897,⁴ and the latter formed the governing body of Rules till the year 1912, when a new series was brought out to regulate the working of the permanent settlement made in that year.⁵ The same was reissued in the Financial Department Resolution No. 361 -E-A. dated July 24, 1916. But as the alterations therein were not in any sense consequential, the series of 1912 may be taken as laying down the final regulations of Provincial Finance.

Recognize as we must the necessity for analysing the rules, we must determine beforehand the point or points of view from which to conduct the analysis. It must be premised at the outset that the object of entering upon the examination of the Rules is twofold: (1) to know what limitations there were and (2) why they were placed. Our immediate interest, it is true, is to state what limitations there were, but this is only a preliminary, if not a minor, object. The second is really the more important of the two. It is only as an aid to the proper understanding of the causes of the necessity for these limitations that a knowledge of them is to be sought. While keeping in our mind the immediate object of stating the limitations, it will be unimaginative not to foresee that in the following chapter,

¹ Financial Department Resolution No. 3334 dated December 14, 1870.

² Financial Department Resolution No. 1709 dated March 22, 1877.

³ Financial Department Resolution No. 1142 of March 17, 1892.

⁴ Financial Department Resolution No. 3551 dated August 11, 1897.

⁵ Financial Department Resolution No. 249-E.A. dated July 15, 1912.

in which we shall be presently engaged, we will learn that the necessity for these limitations arose from the very peculiar nature of Provincial Finance itself. On the other hand, it is important to anticipate this conclusion, and instead of producing the Rules *seriatim* as they occur, arrange them in such a way that they shall be an external register of the internal conception of Provincial Finance which particularly pervaded the minds of its promoters. For the consummation of this end, the labours of the officials in charge of Provincial Finance who have laid down these rules are of no avail. To them these rules were only instruments of financial control, and it did not therefore matter in what order they were grouped. On the other hand, to get at the conception behind these rules it is necessary to classify and group them according to the purposes they were calculated to subserve. But the cardinal point in the matter of classification lies in defining the likely purposes which the originators of such an interrelated scheme of Provincial Finance as obtained in India must have had in view. Without being at all dogmatic, it may be said that for a successful working of such a scheme rules would have to be laid down for the purposes of defining (1) the Administrative and (2) Financial Powers of the Provincial Government. Each of the two categories may be further subdivided for a clearer understanding of the nature of Provincial Finance. Thus the Rules relating to Administrative Powers may be further subdivided into those pertaining to (i) Services and (ii) Staff. Similarly the Rules defining the Financial Powers may be conveniently grouped under the following subsidiary categories : Those (i) of a general nature and those pertaining to (ii) Provincial revenues; (iii) Provincial Expenditure, (iv) Budget Sanction and (v) Audit and Account.

Taking purpose as the *fundamentum divisionis*, the above categories may be supposed to exhaust the possible purposes that the framers of the scheme may be said to have had in mind. On the basis of these categories we may therefore proceed to reduce the amorphous mass of Rules into a digest which, it may be hoped, will be convenient and instructive at the same time.

I. LIMITATIONS ON ADMINISTRATIVE POWERS

(1) *Rules of Inter-Provincial Services*

For regulating the inter-provincial or inter-departmental relations affected by the creation of separate budgets for the different

Provinces, it was ordained that—

- (i) No inter-provincial adjustments were to be allowed.
- (ii) No service previously rendered to other Departments at the charge of the Department made over to the control of the Provincial Governments was to be abolished, and no service previously rendered to these departments at the charge of other departments was to be increased.
- (iii) No line of through communication was to be abandoned or allowed to fall out of repair.

(2) Rules pertaining to Staff

As to the staff engaged in the execution of the provincialized services the Provincial Governments were enjoined *not* to—

- (i) Create a permanent appointment or augment the pay and allowance of any appointment.

Prior to 1912 this applied to appointments with a pay of Rs. 250 a month and above.¹ But after 1912 it applied only to appointments ordinarily held by a Gazetted Officer or by an officer of the Imperial Service as defined in Article 29-B of the Civil Service Regulations.²

- (ii) Create a temporary appointments *or* deputation for an Officer.

Prior to 1912 this applied to appointments with a pay of Rs. 250 a month and above.³ But after 1912 it applied to such of the appointments the remuneration of which exceeded Rs. 2,500 a month, or Rs. 800 a month, if the temporary appointment or deputation was expected to last for more than two years.⁴

- (iii) Abolish a permanent appointment or reduce the pay and allowances of such an appointment.

This rule was in the beginning applied to such appointments the remuneration of which exceeded Rs. 250 a month.⁵ After 1912 it was confined to such appointments as were held by Gazetted Civil Officers recruited in England or as were defined by Article 29-B of the Civil Service Regulations.⁶

- (iv) Grant to a Civil officer in Government employ or in receipt of a service pension.

¹ Rule 4 (3) (a) of 1897.

⁴ Rule 10 (4) (a) of 1912.

² Rule 10(1) of 1912.

⁵ Rule 4 (4) of 1897.

³ Rule 4 (3) (b) of 1897.

⁶ Rule 10 (3) of 1912.

- (a) *Land*, except where the grant was made under the ordinary revenue rules of the Province concerned without involving any special concession in money or its equivalent beyond the fact that the grantee received the grant in preference to others.¹
- or (b) An assignment of Land Revenue when the amount exceeded Rs. 600 a year, or the assignment, though within that amount was not limited to three lives and reduced by one-half on each succession. All grants as assignments of Land Revenue made by Provincial Governments to civil officers were to be confined to cases in which the services were of a very distinguished and exceptional character.²
- (v) *Revise* (a) permanent establishments which involved additional expenditure exceeding Rs. 50,000 a year; or (b) rates of substantive pay of any one branch of the service at a cost to that service alone of more than Rs. 25,000 a year, or (c) the average pay of a service of which the maximum pay exceeded Rs. 500 a month and raise it above the average rate approved at the last revision of the service by the Secretary of State or the Government of India, or (d) the local allowances as compensation for dearness of living or for increase of rents in any locality.³

II. LIMITATIONS ON FINANCIAL POWERS

(1) *General*

Before actually detailing with the limitations on the financial powers of the Provincial Governments it is necessary to recall that the financial settlements made with the Provinces consisted in handing over to them certain *heads* of revenue and expenditure. From this accidental feature it is not to be supposed that the settlements were a collection of separate settlements for each head of revenue and expenditure incorporated into the Provincial Budget. To obviate such a construction by the Provincial Governments and the consequences thereof, it was ruled that—

- (1) The Provincial Governments were to understand that the funds assigned to them formed a consolidated grant for all the services *en masse* entrusted to their respective administration and that no claim could therefore lie against the Imperial

¹Rule 10 (9) (a) of 1912.

³ Rule 10 (6) of 1912.

² Rule 10 (9) (b) of 1912.

treasury on the ground that the actual cost of any service exceeded the amount at which it was estimated in the calculations of the consolidated grant.¹

- (2) And they were not to make any extra demands on the Imperial treasury, but were bound to maintain from the funds given to them all the services entrusted to their management in a state of administrative efficiency.²

With regard to the powers of the Provincial Governments concerning the custody of their funds it was ruled :—

- (3) That the funds allotted for their use were to be lodged in the Imperial treasury, and were not to be removed for investment or deposit elsewhere; nor were the provincial Governments competent to withdraw such money except for expenditure upon the public services.³

(2) *Revenue Rules*

Turning from the general limitations to those pertaining to the revenues of the provinces, it should be noted that they were required to maintain themselves within the funds allotted to them by the Central Government at each settlement.

The provinces could not *augment their* resources beyond the yield due to their natural growth by any possible means, for it was provided that Provincial Governments were—

- (i) Not to impose any additional taxation or make any change in the existing system of revenue management.⁴
- (ii) Not to alter or augment within its area the rates of discount upon the retail of Stamps, Court Fee labels, and duties on spirits and drugs.⁵
- (iii) Not to raise *for its own* finances any loans in the open market.⁶

Powerless in the matter of augmenting their resources, the Provincial Governments were not free to will them away to any other authority subordinate to them. To guard against such eventualities it was ruled that Provincial Government were—

¹ Rule 7 of 1877 and 14 of 1897.

² Rule 7 of 1877 and 14 of 1897.

³ Rule 1 (8) of 1877, 4 (11) of 1897, and 5 (6) of 1912.

⁴ Rule 1 (1) of 1877 and subsequent Resolutions.

⁵ Rule 1 (6) of 1877, also embodied in subsequent Resolutions.

⁶ Rule 5 (13) of 1912. It is surprising that the various resolutions on the subject of provincial Finance prior to 1912 do not contain this ruling, though it cannot be doubted that it has been in operation since the commencement of provincial Finance. In the absence of a specific ruling prior to 1912, attention may be invited to the Resolution reviewing the Financial Statement for 1879-80, where it is said “so long, therefore, as a Local Government does not incur debt (*which is absolutely forbidden*), there is etc., etc.” F. S. 1878, Calcutta, p. 5.

- (iv) Not to alienate any item credited to the general revenues, Imperial or Provincial, so as to form an asset of a Local or Special Fund.

This provision as regards the non-alienation of the resources of revenue made over to the provinces was a little relaxed by the Rules of 1912 so that it was permissible for them to assign to a local body or special fund, as defined in Article 33 of Civil Service Regulations, constituted by law, petty items of Wholly Provincial Revenue of a recurring character, not derived from the proceeds of general taxation and not yielding on an average more than Rs. 25,000 a year.¹

- (v) Not to make grants, subventions or assignments from the funds at their disposal to Local or Municipal bodies so as to create a permanent charge on the revenues of India.

This by no means prevented grants, subventions or assignments from being made to local or municipal bodies by the Provincial Governments from their funds although the Government of India had sounded to them a note of warning by declining to bind itself to continue the grants after the expiration of the settlements or to provide for them in the succeeding settlements.² By the Rules of 1912, however, the power of making such grants was more clearly circumscribed so that a Provincial Government could not make (1) recurring grants to local bodies from provincial revenues exceeding Rs. 1,00,000 a year in any one case,³ or (2) non-recurring grants to local bodies exceeding Rs. 10,00,000 in any one case,⁴ or (3) a grant to a charitable or religious institution other than educational, not being outside India, in excess of Rs. 10,000 , a year if recurring, and Rs. 50,000 if non-recurring.⁵

- (vi) Not to make any grants to non-official (1) on political considerations of (a) land, either free of revenue, or on favourable terms, or (b) of assignment of land revenue, if the value of the land or land revenue exceeded Rs. 1,000 a year;⁶ (2) on the consideration of injury to himself or to his family in the event of his death during or in consequence of service rendered to Government, or (3) on the

¹ Rule 5 (5) of 1912.

⁴ Rule 10 (12) (b) of 1912.

² Rule 4 (10) of 1897.

⁵ Rule 10 (10) of 1912.

³ Rule 10 (12) (a) of 1912.

⁶ Rule 10 (7) of 1912.

consideration of exceptional services to the Government of a pension exceeding Rs. 1,000 a year or a gratuity exceeding Rs. 3,000 in any one case.¹

(3) *Rules of Expenditure*

The powers of sanctioning expenditure granted to the Provincial Government were as limited as their revenue powers. While they were free to spend their funds on the services entrusted to them, certain limitations were laid down for the purposes of expressly ruling out certain objects and subjects of expenditure from the provincial domain.

With regard to the *objects* of their expenditure Provincial Governments were required—

- (i) Not to sanction any expenditure from public money on anything outside the category of objects of expenditure recognised by the Government of India.²
- (ii) To confine themselves to the carrying on of the services particularly entrusted to them by the terms of the settlement.

Prior to 1912 they could undertake a “new general service or duty” only if they satisfied the Government of India that they could provide the necessary funds temporarily if it was temporary, and permanently if it was permanent.³ This provision was altered in 1912 so that a Provincial Government could undertake a new general service or duty provided it was not (a) of an unusual nature, or (b) devoted to objects outside the ordinary work of administration, or (c) likely to involve at a later date expenditure beyond its powers of sanction.⁴

- (iii) Not to spend—

- (a) On State ceremonies and assemblies, and on the entertainment at the public charge of distinguished visitors to India more than Rs. 1,00,000.⁵

¹ Rule 10 (8) of 1912.

² Rule 11 of 1897, also embodied in subsequent Resolutions.

³ Rule 4 (2) of 1897.

⁴ Rule 5 (11) of 1912.

⁵ Rule 10(11) of 1912.

- (b) On Railway Carriages especially reserved for the use of high officials otherwise than in connection with the maintenance of the carriage.¹
- (c) On the purchase of a Motor-car or Motor-cycle for the use of an official, or on the maintenance of it otherwise than from the “Contract Grant” with the Head of the province.²
- (d) On the increase of the “Contract Grant” to the Head of the province.³
- (e) On the construction or purchase of a vessel required for inland navigation and for use at ports, the cost of which exceeded Rs. 1,00,000.⁴
- (f) On an Irrigation or other Public Works projects of which the estimated cost chargeable to the general revenues exceeded Rs. 20,00,000 inclusive of establishments, tools and plants. It was however competent for a Provincial Government to spend up to an amount 10 per cent. in excess of the original sanctioned estimate provided such excess was not more than Rs. 12 ½ lakhs inclusive of establishment, tools and plants.⁵

As to the limitations respecting the subjects of provincial expenditure, it was ruled that in virtue of the application of the general condition precedent to the delegation of all authority to disburse public money, that it shall be bona fide for a public purpose, Provincial Governments could not spend from their funds for benefiting—

- (i) Any individual or body of private persons unless in accordance with some declared or established rule or principle recognized by the Government of India.⁶
- (ii) Native States, directly beyond Rs. 10,000 a year on any one project or Rs. 50,000 if non-recurring.⁷

¹ Rule 10 (4) of 1912.

² Rule 10 (6) of 1912.

³ Rule 10 (15) of 1912.

⁴ Rule 10 (17) of 1912.

⁵ Rule 10 (18) of 1912.

⁶ Rule 10 of 1877, also embodied in subsequent Resolutions.

⁷ Rule 10 (13) of 1912.

(4) *Budgetary Rules*

Besides being subject to the ordinary rules of the Budget System introduced into India for the first time by Mr. Wilson in 1860,¹ by which they were required to submit their budget estimates for sanction to the Government of India, and to observe the rules of appropriation in the execution of the grants, Provincial Governments were further given to understand that without the previous consent of the Government of India they—

- (i) Could not exhaust their balances in the Imperial Treasury.

Prior to 1887 a Provincial Government could propose in its budget estimates to draw upon the whole of its balance. But by the Rules then framed the Provincial Government was required to maintain at all time a certain minimum balance in the Imperial treasury, the amount of which varied with each successive settlement.

- (ii) Could not budget for a deficit, that is for provincial expenditure in excess of the provincial revenues of the year.

The stringency of this rule² was a little softened, so that a Province could after 1912 budget for a deficit, if it satisfied the Government of India that the cause was exceptional and non-recurring,³ but it was at the same time provided that, if this drawing upon the balances to make up the deficits resulted in reducing the balance below the prescribed minimum, the budget for a deficit would be sanctioned only if the Government of India was able to allow the Provincial Government in question an overdraft to the extent necessary to restore the balance to the required minimum from the general balances to be repaid in such rates of interest and instalments as may be prescribed.⁴

- (iii) Could not exceed during the currency of the year the expenditure on any head of account as finally sanctioned for it, for that year, by the Government of India.

¹ Rule 11 of 1892, 13 of 1897, and 19 of 1912.

² Rule 8 of 1892.

³ Rule 21 of 1912.

⁴ Rule 21 and 22 of 1912.

It could increase the expenditure only if the increase was counterbalanced by re-appropriation, that is, reduction by the amount of the excess of the sanctioned grant under some other head of account under its control.¹ The powers of reappropriation of Provincial Governments were very extensive, for it could sanction re-appropriation between the grants for provincial expenditure included in its budget, whether under a Wholly Provincial or a Divided Major or Minor Head provided that the aggregate grant of provincial expenditure was not exceeded.²

(5) *Rules of Audit and Account*

Though the Provinces were allowed considerable powers of re-appropriation within their budgets there was imposed upon them the obligation of audit and accounts of the money they spent. The important point to note in this connection is the fact that this obligation of the keeping of accounts and submitting them to audit was an obligation which the Provinces did not owe to their legislatures, but was an obligation which they owed to the Government of India, who had conferred upon them the financial power they exercised. Moreover, the Government of India did not leave the Provinces to discharge this obligation according to their own sweet will by employing their own audit and account staff. On the contrary the responsibility of realizing this obligation was entrusted to the imperial officers of audit and account stationed in the different Provinces, who acted as the critics and guides of Provincial Governments in the matter of administration and interpretation of the Rules discussed above. To facilitate their task Provincial Governments were instructed—

- (i) Not to make any alterations in the form of procedure of public accounts,³ or direct the division of a charge between two or more heads of account. In all such matters they were to abide by the decision of the Comptroller General—an officer of the Imperial Government.⁴

¹ Rule 24 of 1912.

² Rule 25(1) of 1912

³ Rule 1 (a) of 1897 also embodied in subsequent Resolutions.

⁴ Rule 4 (2) of 1897.