Chapter - II

CHAPTER - II

A REVIEW OF DR. B. R. AMBEDKAR'S "THE EVOLUTION OF PROVINCIAL FINANCE IN BRITISH INDIA" (1925)

2.1 INTRODUCTION

In this chapter we briefly but as precisely as possible review, the major contents of "A Evolution of Provincial Finance in British India": to highlight Dr. B. R. Ambedkar's views on federal finance.

Dr. B. R. Ambedkar started his interest in Indian public finance with his dissertation submitted to University of Columbia, U. S. A. The dissertation was titled "Administration and Finance of the East India Company", which was completed and submitted to the University for the degree of Master of Arts on 15th May, 1915. In this dissertation, Dr. Ambedkar explains the system of finance of the East India Company and the structure of its administration. In a brief way, Dr. Ambedkar explains the administrative structure, the revenue structure comprising land revenue, Jamindari settlement, Ryatwari system, the Salt tax, Custums and Octrai. He also makes reference to other minor revenue sources like wheel tax, Judicial fees, Stamp duties, mint revenue etc. Dr. Ambedkar gave in his dissertation the structure of revenue for the period 1792-93 to 1855-56. Dr. Ambedkar also explains the structure of public expenditure under the East India Company Rule for the period 1809-10 and for the year 1856-57.

At onçe stage Dr. Ambedkar describes the entire fiscal system of the East India Company as irresponsible because the East India Company did not project any new scheme of public work but it allowed the old once to follow rapidly into decay.[1]

In this dissertation Dr. Ambedkar also reviewed surplus and deficit years, critically examined the Indian debt, home bond debt and he concluded this dissertation by critically examining the fiscal provisions of Indian Bill which ultimately got converted into the Act of 1858 where the Financial Administration of India was shown to be under the control of the British Parliament exercised through the Governor General of India. However, it is to be noted that because of the proclamation of this Act, the political and economical rule of the East India Company came to an end but this can not be considered as the beginning of federal finance in India.

Dr. B. R. Ambedkar's academic publication "The Evolution of Provincial Finance in British India" (1925) relates to public finances. Dr. Ambedkar drew his main conclusions from his study of the Indian system, which are probably even more relevant now than it was at the time he wrote. what arrangements can be made in a public fiscal system "administratively workable"?[2]

2.2. THE BEGINNING OF THE PROVINCIAL FINANCE

Dr. Ambedkar gave a detailed explanation of formal understanding between the central government and the provincial governments in British India during the period 1833 through 1921. He presented a pioneering study of the origin, development and mechanism of provincial finance in India.

The imperial system of government was established in India in 1833. At that time, the control of government finance was with the government of India. The centralisation of government finances was a lack of success on account of faulty fiscal system marked by wrongful taxes and wasteful expenditure. As a result, after nearly four decades of its operation, it was given up to bad habits. In 1871, a system of the provincial budgets came into force.[3] In a suitable way; major fiscal reforms were introduced in 1921, leading to a complete change of a form of provincial finance in India.

With this overview, now we turn to the details of his analysis.

From the very beginning, the fiscal system of India suffered from disease of financial inadequacy, which was reflected in recurring budget deficits. so the remedy did not merely consist of raising the necessary amount of revenue because of imbalances of the fiscal system of India. The mode of raising the revenue is equally important from the point of view of the stability and productivity of the nation.[4]

Dr. Ambedkar looked at some of the importance of the Montague-Chelmsford reforms in provincial finances. He gave as an example, the despatch of the Secretary of State, which could have been written now: If the financial stability of the provinces is not to be undermined, with ultimate danger to the Government of India itself, it is impossible to think about seriously the continuance of a series of provincial deficits financed by borrowing either direct from the public or from the Central government. But the provincial similarity did not end here. The provinces proposed an increase in their resources by revising the financial arrangements declared formally in the Act.[5]

Dr. Ambedkar observed that the wealth of society is the only ancestral property on which the state can draw but excessive resort to this will cause harm to the nation itself.

Dr. Ambedkar forcefully argued that justice in taxation was remarkable by its absence. It was without mercy, for the lancet was directed not where the blood was thickest but to that part of the body politic which on account of its weakness and poverty most meekly bore the sharp pain. The landlords who passed their lives in comfort, went in for consumption or vicarious leisure on the earnings of the poor tenants, similarly many European civil servants fattened themselves on pay and take up, were supremely exempted from any contribution towards the maintenance of the Government whose main activities were directed towards the maintenance of display of splendour and an advantage. On the other hand, the salt tax and other oppressive taxes continued to harass the industries and the poor.[6]

Dr. Ambedkar squarely blamed the governments for lacking political will to achieve efficient and equitable economic administration; National prosperity may be great and growing and the increase of national wealth may be proceeding unchecked. If under such circumstances enough revenue is not obtained the fault does not lie with the social income. Rather it is a fault of the government, which must be said to have failed to organise and arrange in order the national resources for fiscal purposes. The same was to some extent true of the Indian government. As for the base of taxation, Ambedkar considered income from land as the most likely source to augment state revenue, but he was strongly opposed to the "pernicious effect of the system which bases the tax on a unit of land held."[7]

2.3 VIEWS ON BICAMERALISM

There were two houses of legislature at the centre one represents the nation and the other represents the states which is termed as bicameralism. But Dr. Ambedkar was against the bicameral system because he thought that the relations of the two houses may not be properly regulated and in that case it could be very difficult for a democratic government to function. Although Dr. Ambedkar accepted the idea of an upper chamber representing various units of British India but he was opposed to giving representation to the government of the units or states in this chamber and favoured representation of units as such. Not only he denied representation to the government in power in a state but also aired his views against the representation of special interests such as trade, commerce, landholders and universities in the upper chamber of the federal legislature.[8]

2.3 (A) Views on Centre-State Relations

When Dr. Ambedkar was on the Bombay legislature at that time some of the members have a simple distribution of taxes between Central and State governments on the basis of indirect taxes to the former and direct taxes to the later. He knew that it was not easy to give authority to both the governments for collecting taxes. He also expressed that the taxes such as customs and excise to be collected by the Centre should not be utilized by the states but only by the Central government. Dr. Ambedkar favoured the division of powers between the federal and state governments on the principle of states getting the residuary powers and not the Centre.

Apart from the above observations on the Centre-State relations Ambedkar anticipated the disputes that would emerge during imposition of emergency in a State under Article 356 and said that before resorting to this Article, two measures could be adopted by the President – i) a warning to the concerned province (State) that the things were not happening in it according to the constitution, and ii) if warning fails, to order an election allowing the people of the state to settle matters by themselves.[9]

Dr. Ambedkar was very much for the federal system in India having multi-lingual, multi-religious, communities. He wanted more resources to be in the hands of the Centre and argued against the unnecessary interventions by the federal government in the matters of the States viz., under Article 356 of the Constitution.

Dr. Ambedkar stated that the inequality between the Centre and the States is unfortunate. Take the example of the taxing authority of the Federation over the provinces. It may be noted that the revenues in the Federation come from sources, which fall under two main heads: taxation and non tax revenues. These were[10]

1. Fees in respect of matters included in the Federal List.
2. Any profits, on the work of the postal services, including postal savings banks.
3. Any profits, on the work of Federal Railways.
4. Any profits, from the official place where coins and currency operations are undertaken.
5. Profits, from any other Federal enterprise such as Reserve Bank and

6. Contribution from Federated and non-federated states to the crown.

Revenues from taxation under the Government of India Act, fall under two heads; normal taxation and Extra-normal taxation normal or ordinary taxation includes levy from following sources –

1. Customs duties
2. Export duties
3. Excise duties
4. Salt tax
5. Corporation tax
6. Tax on income, other than agricultural income
7. Property taxes i. e. taxes on capital value of the individual assets or a property.

The Extra-normal tax revenues fall under following heads –

1. Surcharges on income tax
2. Surcharges on succession duties
3. Surcharges on terminal taxes on goods or passengers carried by rail or air and all taxes on railway, the transportation of goods by sea.

Dr. Ambedkar knew clearly the problems of tax proposals. Under the diarchy, when the government is run by a minister recruited from the elected members of the provincial legislature, it would be fruitless to expect tax increases. Dr. Ambedkar said that, if nomination was the general mode of obtaining a seat in the legislature, it was not necessary to mind the prejudices of the electros. If, however, seat is in the gift of the elector, a candidate to the legislature who proposes to touch his pocket has a small chance of success, even though the new taxes are to result in more than proportionate benefit.[11]

2.4 DEVELOPMENT OF PROVINCIAL FINANCE

When Dr. Ambedkar wrote, his thesis at that time the only available writing on the subject of provincial finance was an incomplete and rough drawing by Justice Mahadev Govind Ranade, which was published in 1887. Justice Ranade had covered the period upto 1882 only and had based his analysis on successive five yearly intervals. So the historical development of provincial finance fell into as many stages as the Five Yearly intervals into which the period could be divided. But revenues and expenditures incorporated in the provincial budgets were revised every fifth year but every revision did not change the fundamentals.[12]

Dr. Ambedkar argued that if the history of development of provincial finance is to be divided into stages according to the changes in fundamental basis, then special importance has to be laid on features altogether different in character.

According to Dr. Ambedkar, the provincial financial system in British India (upto 1921) developed through three distinct phases, with its own characteristic arrangement of the Centre's financial support to provinces. He found it more logical and instructive to divide the stages in the growth of provincial finance in accordance with these fundamentals rather than following the mechanical plan of justice Ranade. Dr. Ambedkar called these stages as (i) Budget by Assignment, (ii) Budget by assigned revenues and (iii) Budget by shared revenues.[13]

2.4 (A) Budget by Assignments

The provincial finance was made through the scheme of 'budget by assignment', which prevailed in India for the initial six year period 1871-72 to 1876-77.

Judicious and economical management of resources was the main objective of provincial finance. Certain services like police, education, printing, roads, medical services, registration, jails, civil buildings and miscellaneous, public improvement were delegated to provincial budgets under the scheme. Receipts from these services were given by the Imperial Government to the respective provinces. since these receipts were only a small percentage of the total funds necessary to finance provincial expenditure, lump sum grants were provided by the Imperial Government for achieving balance in provincial budgets.[14]

According to Dr. Ambedkar, the scheme of provincial finance made a good beginning for higher taxes as well as more iniquitous taxation. To reduce the rate of income tax in order to silence a loud cry raised against it by the richer classes it was decided by the Imperial Government to transfer certain works to the provincial governments. The additional deficit that was expected to arise from the income tax reduction was to be managed by curtailing the assignments to provinces. As a result, the provinces had to resort to higher taxation. The method of taxation resorted to for making up the deficit in the provincial budgets was imposition of rates and cesses on the land revenue, already over-burdened class of tax payers.[15] As a matter of justice we should have expected the continuance of the income tax to the relief of the state. But justice was for a long time absent from the financial Secretariat of the Government of India was the comment made by Dr. Amebdkar.[16]

2.4 (B) Budget by Assigned Revenues

The scheme of 'Budget by assigned revenues' was practised during the five year period, 1877-78 to 1881-82. Under this scheme, certain revenues (besides the receipts from the delegated services) were given to the provinces and a special provision was made for what Dr. Ambedkar called the "adjusting assignment". Thus, the total resources of the provinces were of three types (i) receipts from the services incorporated in the provincial budget, (ii) yield of the revenues given to the province concerned and (iii) adjusting assignment.[17]

In this scheme, assignments were computed on the basis of the 'normal yield' from averaging yields over a number of years. It was agreed that when actual yield turned out to be higher than the normal yield, the corresponding imperial assignment was reduced by half of the excess and if it were less than the normal yield, the assignment would be increased by half of the short fall.[18]

2.4 (C) Budget by Shared Revenues

The scheme of 'budget by Shared Revenues' was introduced in 1882-83 and lasted for nearly four decades until major fiscal reforms were introduced in 1921. Under the 'Scheme of Shared Revenues', the heads of account under revenue and expenditure were grouped in three categories: (i) wholly imperial, (ii) wholly provincial and (iii) imperial and provincial jointly. In the third category, revenues and expenditure were shared between the Imperial Government and provinces in some definitely fixed proportion. Changes of assignments by shares in the imperial revenues had the effect of reducing rigidity and making revenues more elastic for the provincial governments. This budget by shared revenues also differed from the earlier arrangements between the Imperial Government and provinces. Earlier arrangements used to be generally on annual basis, subject to repeated renewals. The object of these settlements was to put a definite limit on the demands of the provincial governments on the already too scanty resources of the Imperial Government.[19]

With this consideration, the Government of India had kept the duration of contracts as short as possible because the longer duration would have the imperial treasury for the revenue side of contract.

Dr. Ambedkar observed that what was an advantage to the imperial treasury was from the standpoint of the provincial Government a serious drawback. There was some deficiencies in the short duration for the provincial governments could not adopt a definite financial policy for they feared that the new terms on renewal might compel them either to give up the policy or modify it so seriously as to prejudice its results. This was just the flaw that deteriorated the sound working of provincial finance.[20] This short coming was rectified with the introduction of the scheme of budget by shared revenues in 1882-83 when five yearly contracts were adopted. Dr. Ambedkar reviewed the successive five yearly settlements upto the settlement of 1902-03 in detail and he concluded that the scheme was found to exercise a most pernicious influence on provincial finance. Under the five yearly system the provincial governments were constrained to adopt frugality in the first few years lest their expenditure should prove too much ~~for their expenditure should prove too much~~ for their revenue and extravagant attitude 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.[21]

The Royal Commission on Decentralisation investigated the subject of provincial and Central finances. The Commission submitted its report in 1909 which generally endorsed the then existing arrangements. With some minor adjustment, a permanent settlement was made operational in 1912. Before the merits of the permanent settlement became evident, the provincial finance in British India entered a new phase in 1921 under the major fiscal reforms of 1920-21.[22]

2.5 REFORM OF THE PROVINCIAL FINANCE

On August 20, 1917, there was an unforgettable announcement according to which the British Government adopted the policy of increasing of Indian's branch of the administration and development of self-governing institutions with a view to the progressive realization of responsible government in India as an integral part of the British Empire.

According to Dr. Ambedkar, it marked "the end of one important event and the beginning of a new one". Under the new policy, it was aimed to endow the legislature with the power to make and unmake so that the government would be not only a government of the people and for the people but by the people. This involved far-reaching changes in the administrative, legislative and financial framework of governance. To begin with, it was decided to put in place a responsible government of a limited character in the provinces by the Reforms Act of 1919.[23]

The earlier system was characterised by "a complete subordination of provincial governments to the Central Government." The Central Government had total control over revenues and expenditure through parliamentary states which treated the revenues of India as one and applied them to the purposes of the Government of India as a whole." On the revenue side, since the Central Government had a share in the proceeds it had a strong motive not only in interfering in the Budget estimates of the provinces, but also in interfering in details of administration. Dr. Ambedkar argues that the strong ties of subordination, which bound the provinces to the Central Government, were therefore the main obstacles in the path of provincial autonomy.[24] According to Dr. Ambedkar, the path to provincial independence lay through a satisfactory division of functions and finances between the Central Government and the provinces.

Specified Devolution Rules of the Act of 1919 gave the provinces powers in respect of 52 services and items of administration including public works, education, public health, water supplies, excise, agriculture, land revenue administration, famine relief, police, administration of justice, etc. However, allocating the revenue resources between the Central Government and provinces was a comparatively more difficult task.[25]

Additionally the Act of 1919 imparted freedom to provinces to borrow in their own names, which was denied to them earlier. Act of 1991 thus, brought about a complete demarcation of the boundaries of the field of governance into the Central Government and the provinces government. Dr. Ambedkar stated that such a demarcation of boundaries of the administrative and financial matters was the dream of many of the Indian politicians and statesman. He maintained that the changes in the system of provincial finance introduced in consequence of the Reforms Act of 1919 were not caused by any inherent defects in the system as it stood at that date, but they were effected because the system as a whole was inconsistent with the great revolution which that Act had sought to effect in the governmental system of the country. So really, it was the Act of 1919 that paved the way for achieving the ideal of provincial autonomy.[26]

2.6 A CRITIQUE OF THE REFORMS

Dr. Ambedkar provides a detailed critique of the new arrangements.

(A) For financial adequacy the new arrangement had two sources, which the Government had not been able to marshal earlier properly, viz. the land revenue and the customs revenue.

Considering the land revenue, Dr. Ambedkar argued that land revenue would have been better if the new financial arrangements had managed to replace the permanent settlement system of land revenue by a periodical settlement system. that was one important way of enlarging the general resources of the country and thereby giving adequacy to all governments concerned.

Moreover, in the case of customs revenue, Dr. Ambedkar pointed out that customs revenue was not used to their fullest potential in spite of the crying needs of the exchequer. He attributed this to the fear that lurked in the mind of British government that if the customs revenue was raised, Indian industries would be protected against English Industries and British industries would suffer. He pointed out that the whole policy of India's British government was dictated by the interests of English manufacturers.[27]

(B) Dr. Ambedkar stated that the only solution for placing provincial finance on a sound footing was reduction of expenditure and increase of taxation. Referring to the maxim that 'without sound finance there is no sound government possible and without sound government there is no sound finance possible'. Dr. Ambedkar observed whether or not the system or government established in the provinces by the Reforms Act was a sound syste.[28]

Dr. Ambedkar emphasised that diarchy was a bad form of government because it was opposed to the principles of collective responsibility. If we can make for a good system of government then hybrid executive, divided responsibility, division of functions, reservation of powers are important for good system of government. And where there is no good system of movement there can be little hope for a sound system of finance. So the primary solution is that there should be an undivided movement with a collective responsibility.

One may ask what is the contemporary relevance of Dr. Ambedkar's contribution to public finance. In this regard, following observations are in order.

1. "The evolution of provincial finance in British India" this book has a great historical significance. It is a pioneering piece of work in which Dr. Ambedkar presented an insightful account of fiscal developments in India during the period 1833 through 1921 supported by facts and figures. As his guide, Prof. Seligman observed value of Dr. Ambedkar's contribution was in the systematic fashion in which the facts were narrated and the impartial

analysis of the interesting development that had taken place in his native country.

2. According to the constitution of India, a Finance Commission is appointed at five yearly intervals which makes recommendations regarding devolution of resources between the Central Government and States, and already Ten Finance Commissions have submitted their report and the report of the 11th Finance Commission is awaited. The role of the Finance Commission is importance recognised. However, most people seem to be unaware of the fact that the analytical foundations of the Finance Commission Reports are derived from the perceptive analysis made by Dr. Ambedkar. Therefore, Dr. Ambedkar's contribution to public finance is as relevant today as it was when this pioneering piece of work was first brought out.[29]

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