THE HISTORICAL BACKGROUND
CHAPTER II
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2.1 GENERAL

2.1.1 The forces of the English East India Company defeated Siraj-ud-Daulah, the Nawab of Bengal at the battle of Plassey in 1757. This victory of the British merchant capital over Indian feudalism ushered in the systematic conquest of India. The political conquest had paved the way for the economic subjugation of the country. The rising British capitalism needed raw materials and markets for its expanding factories. It began to reflect in the British colonial policy in India.

2.1.2 During 1760-1830 England went through an industrial revolution. The use of machinery worked by steam power and the factory system signified a quantitative and qualitative leap forwarded in the development of productive forces. World's first train made its maiden run between Stockton and Darlington in England in 1825. Its potential for strategic and economic use in India was recognised.

2.1.3 East India Railway (EIR) and Great Indian Peninsular Railway (GIPR) companies were incorporated in England in 1845. They made
definite proposals for introducing railways in India.

2.1.4 Railway construction in this country started under the State Guarantee and Assistance Scheme which was described as the Old Guarantee Scheme by Lord Dalhousie, the then Governor General of India. The Secretary of State for India entered into a contract with the East Indian and Great Indian Peninsular Railway Companies on August 17, 1849, under which trunk lines were constructed and expanded. Under this guarantee system, the railway companies were assured of:

i) Free grant of land;

ii) A guaranteed rate of interest ranging from 4.5 per cent to 5 per cent;

iii) Reservation of certain powers of supervision and control by the government;

iv) Utilisation of half of the surplus profits earned by the companies to repay to the Government any sums which it might have had previously to make good on account of the guaranteed rate of interest; and

v) Option for the Government to purchase the lines after 25 years or 50 years.
2.1.5 The first railway line was laid from Victoria Terminus (VT), Bombay, to Thana - a distance of 21 miles - as early as 1853. The first train in this country was run on this route by the erstwhile Great Indian Peninsular Railway Company (GTP) on April, 16, 1853. In the Eastern region, the first railway train - the second train in the country - was inaugurated on August 15, 1854, when it left Howrah for Hooghly - a distance of 24 miles on the East India Railway Company (EIR). The following years brought more "ribbons of steel" which were spread over almost all parts of the country cutting across provincial and regional boundaries.

2.1.6 When the terms of the agreements with the railway companies became widely known, the public opinion in India and also in England was highly critical of the terms which were considered to be very generous for the British investors at the expense of the Indian taxpayers. Attempts were, therefore, made in 1862 to secure the construction of railways on terms more favourable to the Government and to induce private investors to construct railways at their own risk and cost subject to land being provided
free and a specified subsidy being guaranteed for a given period. These terms failed to attract private capital and consequently Government had to go back for a short while to the procedure of guaranteeing return on capital invested by the companies together with other conditions referred to earlier.

2.1.7 Within a decade of the signing of the contracts with the guaranteed companies, eight companies sprang up in England for the construction and management of the railways in this country. By then, the guarantee system had become an exploded fallacy. New contracts were entered into with the Oudh-Rohilkhand Railway and the Carnatic Railway in 1867 and 1869, respectively, after some modifications in the earlier contracts.

2.1.8 After the recommendation of the Famine Commission in 1880 for the extension of the railways by 5,000 miles of lines, and following a realisation that transport facilities in the country were inadequate and inefficient, the Government accepted the proposal that a State agency should be responsible for the construction of the railways. At the same time,
however, the idea of the construction of railway lines by private enterprise was accepted because of the financial outlays involved in their construction. Fresh contracts were entered into with six companies - the Bengal Central Railway Company (1881), the Rohilkhand and Kumaon Railway Company (1882), the South Maratha Railway Company (1882), the Bengal and North Western Railway Company (1882), the Indian Midland Railway Company (1885) and the Bengal Nagpur Railway Company (1887).

In pursuance of the revised contract terms, some of the company railways were taken over by the Government management after purchase. The management of some of the other purchased lines was, however, entrusted to private companies constituted under contracts which determined the relationship between the Government and the working companies generally as follows:

i) The lines were the property of the State.

ii) The greater part of the capital belonged to Government.

iii) When funds were required for further capital expenditure, Government had the option either of providing them or of calling on the working company to provide them.
iv) All the contracts were terminable at the option of the Secretary of State for India at specified dates, the Company's capital being repayable at par on termination of the contracts.

v) The Company was required to keep the line in good repair and to maintain sufficient staff for the purpose of operation and maintenance of the line to the satisfaction of the Secretary of State who also had the right to require the company to carry out any alternation or improvement in the line or in its working.

vi) The train services were to be determined by the Secretary of State who also had a general control over the rates quoted by the companies. The Government also retained the power to settle the classification of goods and to authorise maximum and minimum rates within which the companies were to charge the public for the conveyance of passengers and goods of each class.

vii) The companies had to keep such accounts as the Secretary of State may require and these were subject to audit by the...
viii) All expenditure by the company had to be stated and submitted for the sanction of the Secretary of State, and finally

ix) in all other matters relating to the line, the company was subject to the supervision and control of the Secretary of State.

2.1.10 It is clear that with these conditions the management of Government railways as well as the management of the company-owned railways came under strict supervision and control of the Government. With the progress of construction of the railways, it became necessary to consolidate, amend and add to the rudimentary law than existing for the railways in India and to provide for a suitable machinery for regulating the working of the various railway systems. The Indian Railways Act, 1890, was accordingly promulgated to take effect from 1st May, 1890. The Railway Board was constituted in 1905 under the Indian Railway Board Act; the powers of the Central Government under the Indian Railways' Act, 1890 were transferred to the Railway Board which now exercises all the authority over the Indian railway system.
The twentieth century opened with a boom for the railways, both in expansion and in profits. During the first 40 years, the railways lost Rs.58 crores. It was only from 1900 onwards that a net return on the capital outlay was realised. The railway mileage increased from 24,752 in 1900 to 34,656 in 1914. The number of travelling passengers increased from 24 million in 1901 to 42 million in 1917. But this remarkable expansion of the railways was not an unmixed blessing. The position became somewhat critical between 1914 and 1920. The demand for railway services increased enormously because of the heavy movement of troops and war materials. The difficulty of importing railway equipment and rolling stock for renewal and replacement adversely affected the expansion programme. The railways were increasingly utilised to meet Britain's war needs; their workshops were therefore impelled to divert their resources to the production of high explosive shells and other war equipment. These workshops were so heavily overloaded that they were not able to handle their vastly increased load of repairs. The net effect of this was the reduction of
passenger services, congestion in trains and reduction in speed because of the worn-out track and ageing locomotives.

2.1.12 The railways had deteriorated in efficiency, and the management was severely criticised by the public. The East Indian Company Inquiry Committee was appointed under the Chairmanship of Sir William Acworth on 1st November, 1920 to report whether it would be desirable for the State to take over the management of the railways. The committee recommended direct State management on a commercial basis so that it might earn high dividends. It further recommended the establishment of a railway rate tribunal and an advisory committee, and the replacement of the Railway Board by a Railway Commission. Accepting the recommendations of the Ackworth Committee, the Government took over the management of the East India Railway and the G.I.P. Railway in 1924 and 1925, respectively. The Railway Commission, however, was not established; but the Railway Board was reorganised. The Government also acquired the Burma Railway Company. Electric traction too was introduced in
Bombay and Madras a milestone in the development of rail transport in India.

2.1.13 Initially the Railway Finances formed part of the General Finances of the Government. These Finances were separated from the General Finances from 1924-25, mainly to relieve the General budget from the violent fluctuations caused by the incorporation therein of the railway estimates and to enable railways to carry out a continuous railway policy based on the necessity of making a definite return to general revenues, on the money expended by the State on railways.

2.1.14 The return on the capital to be paid by the Railways and other ancillary matters were to be decided by the Legislature on the recommendations of what came to be known as the Railway Convention Committee to be appointed by the Legislature from time to time. The returns expected from the Railways have been fixed in this manner, starting from 1924.

2.1.15 The main features of the 1924 Separation Convention were as follows:

a) Government of India (in the Finance Department) became the sole shareholder in the Railway Undertaking.
b) A fixed annual contribution would be made by the railways as a first charge on their net receipts, the contribution being based on capital-at-charge.

c) A Railway Reserve Fund was set up to be operated as a sort of dividend equalisation reserve.

d) A Railway Depreciation Fund was created to meet the cost of replacements and renewals.

e) A Standing Finance Committee of the Legislature was set up to examine the estimates of railway expenditure before these estimates were submitted to the Legislative Assembly.

f) The Railway Budget would be presented separately, and ahead of the General Budget, to the Legislature and the expenditure proposed voted separately in the form of Demands for Grants.

2.1.16 The years from 1931 to 1936 were, however, a period of depression for the railways. The industry was in very strained financial conditions, and new investment was practically negligible. Floods and earthquakes had impaired or destroyed railway tracks and adversely
affected the financial conditions of the railways. It was in these circumstances that the Government appointed the Wedgwood Committee under the Chairmanship of Sir Ralph Wedgwood, then Chief General Manager of the London and the North-Eastern Railway, to examine the position of the State-owned railways and suggest measures to bring about a substantial rise in their net earnings. Among Committee's many recommendations was the suggestion that a Reserve Fund and a Depreciation Fund should be established, and that a Commercial department and a suitable machinery be set up to look after the commercial interests of the railways and their publicity and public relations functions. Almost all the recommendations of the Committee were accepted. Soon there was a distinct improvement in the operations of the railways. By 1939, the total route mileage went up to 41,156. The financial position of the railways registered a distinct improvement after 1937. When, however, the Second World War broke out in 1939, the railways were once again subjected to heavy strains. They had to release locomotives, wagons and track materials for service in the Middle East, which led to the dismantling of 28 branch lines.
War Transport Board was created in 1942 to organise alternative modes of transport and ensure that military interests and essential services did not suffer. Workshops were directed to manufacture shells and other war materials. The railways were extensively used to move troops and war materials. There was a clamorous demand for the railway services for civilians and civilian purposes. In order to relieve congestion and ensure a prompt movement of troops, passengers, goods and war materials, a Central Transport Organisation was set up. The Bengal famine of 1943 imposed a further burdensome responsibility on the railways, which were now required to transport vast quantities of food to feed the famine-stricken areas.

2.1.17 After the war, the railways suffered another jolt: the partition of the country into India and Pakistan resulted in a division of the railway mileage, assets and staff, which created new problems and placed fresh burdens on the already battered railway system. The route mileage after partition went down to 34,083. The Government nationalised all the 42 railway companies which were in operation and brought
them under State management and control and the entire railway system was reorganised into nine zonal railway systems.

2.1.18 During the war, the 1924 convention was suspended with effect from 1st April, 1943 and the Railways' surplus was allocated to the General Revenues on an ad-hoc basis each year. This continued till 1949-50. The Railways could earn substantial profits during the year 1943-44 to 1945-46 and contributed between 7.4 per cent to 8.5 per cent of the capital-at-charge to the General Revenues, including interest charges. For the remaining years, (excluding 1947-48 the total contributions paid by the Railways ranged from 4.1 per cent to 4.9 per cent of the capital-at-charge.

2.1.19 The Separation Convention was reviewed and revised in 1949, 1954, 1960, 1965, 1971 and 1973. As a result of these reviews, the contributions to be made by the railway undertaking to the General Revenues has been revised to accord with the average borrowing rate of the Government of India. The railways are authorised to borrow temporarily from the Central Government for meeting their dividend obligations if so required. It is interesting to
note that the Indian Railways are perhaps the only Government Railways in the world which have been meeting their dividend obligations despite carrying heavy social burdens. Apart from the Railway Revenue Reserve Fund and the Depreciation Reserve Fund, the railways also now operate the Development Fund, the Accident Compensation, Safety and Passenger Amenities Fund (ACSPAF) and the Pension Fund.

2.2 EXPECTED RETURN FROM NEW PROJECTS

2.2.1 In the early years of the development of the Railways, it was expected that a project, after meeting the cost of operation, repairs and maintenance, depreciation and interest charges should generate a 'fair' margin of profit. In 1937, the Wedgewood Committee made a critical comment that the capital expenditure on the Railways had been on too lavish a scale. Following this, a net return of at least 10% was prescribed. The Railway Convention Committee of 1949 recommended a return of 4.25 per cent on the basis of a dividend rate of 4% at that time. This was reviewed by the Railway Convention Committee (1954), which raised it to 5%. Currently a net return of 6.75% on investment is
considered appropriate. Alternatively, a return of 10% by Discounted Cash Flow method is taken as adequate to justify a new project.

2.3 CAPITAL-AT-CHARGE

2.3.1 The capital structure of the Indian Government railways may be said to comprise broadly:

a) "capital-at-charge" denoting the capital invested by the Central Government on which the railway undertaking is obliged to pay dividend at a specified rate, and

b) expenditure incurred on creation of the assets from within the railway undertaking's own resources.

2.3.2 The sum of the two is referred to as the "Block" or total investment which, therefore, consists of money invested by the Government of India as well as those raised internally by the Railway Undertaking. The table on next page indicates the growth of capital-at-charge and the block (total investment).

2.3.3 It will be observed that while the Railways have a total investment by Central Government of over 60 billion rupees as on 31.3.1981, they were able to raise internal resources of the order of a further 14 billion rupees so that the
### TABLE 1

**Investments in Railways (Rs/million)**

<table>
<thead>
<tr>
<th>As at 31st March</th>
<th>Capital-at-Charge</th>
<th>Total Investment</th>
</tr>
</thead>
<tbody>
<tr>
<td>1951</td>
<td>8 270</td>
<td>8 552</td>
</tr>
<tr>
<td>1966</td>
<td>26 803</td>
<td>32 555</td>
</tr>
<tr>
<td>1975</td>
<td>41 056</td>
<td>50 503</td>
</tr>
<tr>
<td>1977</td>
<td>45 337</td>
<td>55 724</td>
</tr>
<tr>
<td>1981</td>
<td>60 964</td>
<td>74 484</td>
</tr>
<tr>
<td>1985</td>
<td>82 860</td>
<td>103 770</td>
</tr>
</tbody>
</table>
31

gross investment in the railways amounted to 74 billion rupees as on 31st March 1981.
2.3.4 Not the whole of the capital-at-charge, i.e. sums borrowed from the Central Government, carries dividend liability. For example, outlays on strategic railway lines, un-remunerative branch lines, railway lines of the North East Frontier Railway, etc. are free from dividend obligation as a result of a special arrangement approved by the Central Government on the recommendations of a Parliamentary Committee. Despite these concessions, the dividend liability of the railway undertaking in respect of capital contributed by the Central Government has been rising very substantially and is now of the order of over two billion rupees per annum.

2.4 EXPECTED RATE OF RETURN FROM RAILWAYS

2.4.1 The Government of India (Ministry of Finance) have issued 'Guidelines for price fixation' in September, 1976. The guidelines recommended that "the rate of return in general should be calculated on net worth of a company (e.g. share capital plus free reserves) rather than total capital employed". The guidelines recommended that the rate of return should consist of two components:-
a) basic minimum which would be uniform as between industries, and

b) an additional variable component which may be varied from industry to industry depending on differences with respect to factors such as risk, priority, growth prospects, need for internal generation of funds, degree of obsolescence of capital stocks and capital structure including reserves. The guidelines recommended that "the basic minimum component of the rate of return may be equal to the going rate on bank deposits of five years' duration."

2.4.2 The Draft Sixth Plan has suggested that the "return from investments in Central and State Enterprises should be raised" by economics and price adjustments to a post-tax level of about 10%.

2.5 FINANCIAL PERFORMANCE OF MAJOR FOREIGN RAILWAYS

2.5.1 The differing accounting practices, the fact that foreign railways undertake a number of activities besides railway transport, and other such factors make a comparison of financial performance with foreign railways rather difficult. It may be useful nevertheless to have
some idea about the financial working of major foreign railways. Information regarding the net surplus deficit of the major foreign railway systems during the year 1975, before provision for national income taxes but after interest payments, is given in the Table (2) on the next page.

2.5.2 It will be observed that even after taking into account government subsidies, only two railway systems were able to earn net surplus, while a third system earned only a nominal surplus during 1975. All other systems incurred losses ranging from $36 million to over $3,000 million. After excluding government subsidies, only two railroad systems have generated net surpluses while the deficit suffered by other systems varied from $171 million to more than $4 billion. Apart from subsidies directly included in income, certain systems received grants. Inclusive of all such subsidies, it is interesting to note that subsidies ranged from around 3% of the total revenue to over 60%.

2.5.3 Compared to the financial performance of these foreign rail road systems, performance of the Indian railways cannot be considered unsatisfactory. However, certain important
### TABLE 2

Financial Performance of Major Foreign Railways

<table>
<thead>
<tr>
<th>Subsidies (loss) includes in income</th>
<th>Net Income* (loss) as reported</th>
<th>Subsidies (loss) excluding subsidies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Privately owned Systems</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. US Class I Railroads :</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Excluding Amtrak</td>
<td>317</td>
<td>152</td>
</tr>
<tr>
<td>Incuding Amtrak</td>
<td>(36)</td>
<td>157</td>
</tr>
<tr>
<td>2. Canadian Pacific Ltd.</td>
<td>333</td>
<td>70</td>
</tr>
<tr>
<td>Government owned Systems</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. South African Railways</td>
<td>(141)</td>
<td>30</td>
</tr>
<tr>
<td>4. Canadian National Railways</td>
<td>(168)</td>
<td>269</td>
</tr>
<tr>
<td>5. British Railways</td>
<td>11</td>
<td>829</td>
</tr>
<tr>
<td>6. Italian State Railways</td>
<td>(1,188)</td>
<td>1,252</td>
</tr>
<tr>
<td>7. French National Railways</td>
<td>(265)</td>
<td>3,111</td>
</tr>
<tr>
<td>8. Japanese National Railways</td>
<td>(3,027)</td>
<td>649</td>
</tr>
<tr>
<td>9. German Federal Railways</td>
<td>(1,665)</td>
<td>2,386</td>
</tr>
</tbody>
</table>

*NET SURPLUS
points may have to be kept in mind in attempting such a comparison. All of these foreign rail systems are in advanced developed countries. In view of the important developments of road transport, and especially personalised automobile transport, railways have ceased in these countries to be the major carriers of people and freight.

2.5.4 The situation is different in a country like India where, due to its vast size, the stage of development and resource constraints, railways continue to be the most important means of transport and will probably so continue for quite some time. The losses suffered by most of the foreign railway systems are mainly due to considerable under-utilisation of the assets created in the past. In India, the position is quite different. The problems here relate to shortage of transport facilities resulting in over-crowding in passenger trains and inadequate availability of wagons for goods traffic. Therefore, it may not be inappropriate to expect reasonable profits from railway operations here. It is therefore not unreasonable to expect that the railways should be in a position to generate a surplus to provide funds for further expansion.