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MADRAS RECORD OFFICE

Government of Madras

Public works DEPARTMENT

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*Proceedings of the Madras Government, Public Works Department,
24th August 1874.*

No. 590. Read the following Proceedings of the Government of India in the Public Works Department, (Railway,) dated Fort William, 21st July 1874, Nos. 1,664-70 R. :—

Expediency of abolishing the Fire Insurance and Renewal, Reserve and other similar Funds on Guaranteed Railways.

Read again—

From the Government of India, to the Secretary of State for India, dated 21st August 1863, No. 123 R.

We have the honor to acknowledge the receipt of your Despatch, No. 40, dated the 21st May 1863, relative to the formation of the proposed Renewal Fund of the Great Indian Peninsula Railway.

2. We observe that the question of the establishment of a Renewal Fund is under the consideration of at least one other Company, and we therefore address you on the subject generally; for as the object of these funds is to prevent unusual expenses from falling inconveniently on the shareholders' dividends, they should, in our opinion, be established, if at all, either out of the 5 per cent. guaranteed interest, or out of the shareholders' moiety of the surplus profits when there are any.

3. The shareholders get their 5 per cent. guaranteed dividend whatever the expenses of working and maintenance may be, and it is therefore clear that the Government takes upon itself, under the contract, to be the Reserve or Renewal Fund so long as the profits are under 5 per cent.

4. The Government, moreover, undertakes this office in a way exceedingly advantageous to the shareholders, and very costly to itself. It makes up the dividend to 5 per cent. and lets the outlay incurred with this object, though bearing simple interest at per 5 cent., lie by until it is gradually paid off by the slow accumulations of a moiety of the surplus profits. Until the surplus profits regularly come to 5 per cent. upon the outlay, it resembles an advance to be repaid without interest. It is not probable that this regular realization of surplus profits will take place for a long time to come, if at all. If it be deemed reasonable to expect it twenty years hence, the advances made, with the simple interest accumulated thereon, will be equivalent to a loan of which no repayment or interest is to be paid for twenty years. The ordinary tables of deferred payments show that such an advance is equivalent to a free gift of more than half the money.

5. A Reserve or Renewal Fund formed by deductions from earnings when the profits are under 5 per cent., is a reduction of the amount which the Government would receive in mitigation of its payments of guaranteed interest. In other words, the amount of such deductions, or of such fund in fact, is an increase of the advances made by Government under the above unfavorable terms. It would be, in fact, a free gift to the shareholders of more than half the balance of the fund. The Government is not obliged by the contract to allow of the formation of such funds on these terms.

6. It is said "of the balance of the fund," because the disadvantage would be abated to the extent of the payments out of the fund, in some degree. That is to say, that if extensive renewals were required in any half-year when there was not a sufficient surplus profit to meet them, the Government would have to

make good the amount if there were no fund, and would avoid additional payments for this so far as the money previously advanced to such fund was available. But there would be no advantage to Government in such a modified mode of paying for renewals. The amount to be paid for guaranteed interest is always more or less fluctuating, and it is not worthwhile to pay for making it a little less so, even if the effect of such funds on fluctuations would be appreciable, which is doubtful.

7. The only effect of the formation of such funds would really be that when there was a surplus profit in a half-year when heavy renewals were necessary, this fund might be drawn upon so as to retain to the shareholders the benefit of the surplus. The money which was taken out of the Government Treasuries in previous half-years would thus be paid to the shareholders on such occasions. Such an arrangement is manifestly unfair. If the Government were to accede to it, an equivalent should be insisted on for the concession made.

* * * * *

From the Government of India, to the Secretary of State for India, dated 23rd February 1871, No. 14 R.

On receipt of your Grace's Despatch to the Government of Bombay, No. 37, of the 8th December last, wherein it was intimated that, as experience seemed to show that the present contribution of 7 per cent. from the gross revenue did not suffice to keep the Renewal Fund of the Great Indian Peninsula Railway solvent, you had suggested to the Directors the propriety of augmenting the contribution, we had the honor of addressing your Grace by telegraph to the effect that the propriety of suggesting the abolition of the Renewal and other like funds of the several Guaranteed Railway Companies in India was under consideration, and that, pending a final decision in the matter being arrived at, we thought it desirable that no fresh arrangements should be sanctioned.

2. In our Despatch, No. 123 R., of the 21st August 1868, to Sir S. Northcote, we explained the views entertained by the Government of India on the question of creating Renewal Funds generally. In addition to what we then stated, we would now observe that the general object of these Railway Funds of all descriptions is to prevent any unusually large charge being brought against the receipts of any half-year and thus to ensure a tolerably uniform dividend. Such a system is, no doubt, commercially sound, and properly applicable to Railways working without a guarantee.

3. But this does not by any means hold good for Railways working under a guarantee of interest from Government. Companies thus guaranteed have provided for them by the Government an unfailing Reserve Fund upon which to draw whenever any circumstances may depress the net income earned below the fixed rate of guaranteed interest. There seems no object in keeping up special funds to prevent extraordinary fluctuations of charge or income in their case, and such funds only cause useless complications of account, being altogether fictitious: the sums standing at credit of these funds merely representing amounts which the Company may draw from the Government Treasury, under certain circumstances, to the relief of current revenue. With so high a rate of interest on the subscribed capital as 5 per cent., guaranteed without fail, it certainly seems needless to take steps for preventing fluctuations in the dividend of the Company above that rate. At all events, it may reasonably be left for experience to show that such a further precaution is really necessary, when the earnings of any of the Companies are so systematically in excess of the guaranteed rate as to render a fall to that rate seriously inconvenient.

4. Again, under the arrangement which gives the Government half the profits in excess of the guaranteed interest, one-half of all payments to Reserve Funds, when the profits are so in excess, are directly thrown on the Government as a reduction of its share of the profits. More-

over, the sums at the credit of these funds, whether lodged in the Government Treasury or invested in Government Securities, carry interest which is charged against the Government, though the Government, in the case of a Company not earning up to the guaranteed interest, has contributed the whole of the assets by the corresponding payment as guaranteed interest; and in the case of the income exceeding the guaranteed has most likely contributed in like manner for the largest part of the assets.

5. On the whole, we are decidedly of opinion that sanction of the formation of any other funds of this nature should be refused, and further contributions to the existing funds of all descriptions should be stopped. This at all events will save the State from any further loss by reason of these arrangements.

6. It would also be desirable, if possible, to abolish the existing funds altogether, the assets being brought forward as revenue, and the Companies might well let them go and be contented in years of exceptional loss with the minimum dividend guaranteed by the Secretary of State.

From the Government of India, to the Secretary of State for India, dated 23rd January 1874, No. 13 R.

In continuation of our telegram of the 3rd instant, and with reference to the Bombay Government's Despatch No. 22 Railway of the 29th November, forwarding for confirmation certain draft rules proposed for the working of the Great Indian Peninsula Railway Permanent-way Renewal Fund from the 1st January 1874, we would now again express our earnest desire that the circumstances of this fund should be carefully considered prior to sanction to its continuation in any shape.

2. In various despatches addressed to your Grace from 1868 to 1871, we gave our reasons for objecting to the establishment, in connection with Guaranteed Railways, of such Reserve Funds in general, and of this fund in particular. In your Grace's Despatch No. 24 Railway of the 4th May 1871, it was stated that the contribution to this fund should continue until the time originally fixed for re-opening the question, when the utility of any Renewal Fund whatever should be considered. This time has now arrived.

3. It will be useful, in the first instance, to review the circumstances of the origin of this fund. Great failures of works had taken place, and others were apprehended on the Great Indian Peninsula Railway; and the question arose, whether, as in the case of ordinary maintenance, Revenue should bear the outlay requisite to restore and strengthen the works. The Directors desired to throw the entire cost on capital.

4. About the same time, the question presented itself as to the division of the surplus which had been earned in the half-year ended 30th June 1867. The first failure occurred in the ensuing month of July, the immediate consequence of which was, distrust of the works throughout the line followed by inquiry as to their condition. The result was that the Consulting Engineer was unable to certify (on the Revenue Accounts for the half-year) that the works were in good order, and the Secretary of State declined to permit the surplus profits to be divided.

5. To this the Directors demurred, and in order to obviate controversy in the future, they proposed "that some provision should be made out of income for equalizing over a series of years, the charge for reconstructions, and for the periodically heavy renewal of permanent-way," remarking that "it was evidently the intention of the contract, and the subject has been mooted on the part of Government." This proposal was supplemented with some details as to the method of establishing funds for these objects.

6. Thereupon the Secretary of State issued orders that the surplus profits in question should be appropriated to the restoration, strengthening, etc., of the works, and that whatever additional sum might be required for those purposes should be met from Capital, provided the Directors agreed to the establishment of the funds they had proposed.

7. Thus, to a question relating solely to extraordinary casualties to works, was superadded that of the creation of a fund to provide for ordinary renewals, and the two were dealt with apparently as if they were of a cognate character. This was five years ago.

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24th August 1874.*

8. The present position of the "Permanent-way Renewal" Fund is as follows. On the 31st December 1872 the credit balance was £172,664. On the 30th June 1873 this balance had grown to £230,508, and by the 31st December 1873 it must, under the rules then in force, have been considerably in excess of the 25 lakhs of Rupees to which it is proposed in the enclosures to the Bombay Government Despatch No. 22 of 1873 to limit the fund.

9. Of the credit balance, at least £14,000 have been contributed by the Government, as interest on money which from half-year to half-year during the last five years, the State has diverted from its own Treasury to form the fund, and the fund be maintained in the future at 25 lakhs of Rupees, the interest on that sum will practically be a perpetual contribution by the State to the Revenue Maintenance Account of the Railway.

10. So long as surplus profits are not earned, it may be conceded that the existence of this fund is a mere matter of accounts, but, as stated in one of our earlier Despatches on this subject, heavy renewals shall have been necessary, it will be drawn upon so as to retain to the shareholders the benefit of the surplus, and the money which was taken out of the Government Treasuries in previous half-years will thus be paid to the shareholders on such occasions.

11. As remarked in that Despatch this "arrangement is manifestly unfair," and "as the object of these funds is to prevent unusual expenses from falling inconveniently on the shareholders' dividends, they should, in our opinion, be established, if at all, either out of the 5 per cent. guaranteed interest, or out of the shareholders' moiety of the surplus profits when there are any," for, as "the shareholders get their 5 per cent. guaranteed dividend whatever the expense of working and maintenance may be," the State Treasury is really the "renewal fund so long as the profits are under 5 per cent."

12. It is true that such funds are contemplated in the contract, but it is obvious that the conditions applicable to a Railway working without a guarantee are not necessarily applicable in this case, and if it be contended that because provided for in the contract the establishment of such funds cannot be refused, or the abolition of those in existence cannot be decreed, the Government, as one party to the contract, may, with justice, insist on such a modification of the terms applicable to ordinary commercial undertakings, as will make them fairly applicable to guaranteed undertakings.

13. For our more detailed views, we would refer your Grace to our previous Despatches regarding the establishment of this and other Reserve Funds on Guaranteed Railways, and particularly to Nos. 123 of 1868 and 14 of 1871, and trust, now that the opportunity has occurred, that your Grace will endeavour to abolish this fund, or failing that, so to limit its dimensions and to modify the conditions of its existence as to remove the more serious objections that we entertain to it.

14. It is not improbable that this Railway may soon earn a surplus over the guaranteed interest, and should your Grace determine to withdraw your sanction to the continuance of the fund, the balance should be credited to Government, so as not to create, or augment, a surplus. In this view it would, probably, be well to credit the assets in reduction of the guaranteed interest debt of the Company which now amounts to about 5 millions sterling.

15. The objections to this particular fund are, in our view, alike applicable to the Reserve Funds of all Guaranteed Railways, and we would further urge that every such fund should be abolished as opportunity may offer, and that on no consideration should the contribution to any existing fund be increased.

From the Secretary of State for India, to the Government of India, dated 23rd April 1874,
No. 56 R.

I HAVE had under consideration in Council your Excellency's Despatch No. 13 of the 23rd January last, in which, for reasons therein assigned, and in continuation of previous Despatches to the same purport, you urge the expediency of abolishing the Great Indian Peninsula Railway

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24th August 1874.*

Company's Permanent-way Renewal Fund, which was established experimentally by my predecessor, Sir Stafford Northcote, on the 24th January 1868 for five years, which have now expired.

2. In a Despatch No. 68 of 30th August 1871, in reply to your Despatch No. 60 of the 7th of the preceding June, you were apprised by the Duke of Argyll of his opinion that "on Railways not earning, and not likely to earn, surplus profits, no possible advantage to Government can result by the maintenance of Renewal and other similar funds kept up by contributions from Revenue." In such cases it is obvious that the so-called Fund is a mere fiction, by which nothing is gained but extra trouble and complication of accounts, with this further disadvantage, that if ever the Railway concerned should come to earn a surplus, and if, as in the case under consideration, the so-called fund should have been entirely created by the Government, it would then be made to pay for renewals, while the shareholders were taking their full benefit of the surplus, out of which, in fact, the renewals would have been made if there had been no Renewal Fund in existence. On the other hand, if the Railway should at any time work at a loss, that loss, to a greater or less amount, according to circumstances, would fall on the fund, i. e., on the Government, instead of on the shareholders as provided by the contract.

3. I can, therefore, have no hesitation in acceding to your recommendation that, as regards the Railway in question, which is not paying, and not likely for some time to pay, a surplus, the Government should cease to sanction any contribution to the Permanent-way Renewal Fund.

4. The argument in the 10th paragraph of your Despatch, though correct in the case of a Railway not paying a surplus over 5 per cent., when the fund must consist entirely of Government contributions, would require some modification in cases where the fund had received contributions from surplus profits of the Railway over 5 per cent. In such cases, the cost of extraordinary renewals would be partly met from monies which would have otherwise been distributed to the shareholders. But I do not consider that this small and uncertain advantage could be set against the disadvantage to Government of the plan, while in all such cases a door would necessarily be open to practices difficult to prevent or provide against, and likely to throw an unfair proportion of renewal charges on the Government.

5. For similar reasons, it is obvious that the Casualty Fund of the Great Indian Peninsula Railway, and the Fire Insurance Funds of other Guaranteed Railways do not tend to the advantage of Government, for unless these funds had been formed entirely from surplus profits over 5 per cent., which has certainly not been the case, it is evident that any charge met from them must fall in undue proportion, and may fall entirely, on the Government.

6. I shall, therefore, not sanction in future the formation of any such funds, and I will, as opportunity may arise, endeavour to arrange for the abolition of those already existing.

The Governments of Madras and Bombay.
The Consulting Engineers, Calcutta, Lahore and Lucknow.
The Accountant-General, Public Works Department, and to
the Financial Department.

ORDER.—Ordered that copies of these Despatches be forwarded to the Governments and Officers noted in the margin for information.

(Signed) H. DRUMMOND, Colonel, R.E.,
Deputy Secretary.

No. 591.

ORDER THEREON, 24th August 1874, No. 2,395.

RAILWAY, No. 85.

COMMUNICATED to the Consulting Engineer for Railways.

Proceedings of the Madras Government, Public Works Department,
24th August 1874.

2. It would appear that the only fund on the Madras Railways of the nature
of those referred to in these papers is the Fire Insurance Fund.

(True Extract.)

(Signed) G. W. WALKER, Colonel, R.E.,
Secretary to Government.

To the Consulting Engineer for Railways.
.. Officiating Examiner of Railway Accounts.

*Pls. Confess
Examiner 1st. 24th Aug 1874.*

*Communicated to the Consulting Engineer for Railways.
It would appear that the only fund on the Madras Railways of the nature
of those referred to in these papers is the Fire Insurance Fund.*

*540-591.
Recd 4/8/74 R.E. 4/8/74
Dep'ty Secy 28 July 1874*

W. J. ...
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GOVERNMENT OF INDIA.

PUBLIC WORKS DEPARTMENT.

RAILWAY.

To

Nos. 1664—70 R.

Dated July 21, 1874.

Received *28th* }

El. No. 2395.24-8-74.

*Expediency of abolishing the Fire Insurance
and Renewal, Reserve, and other similar Funds
on Guaranteed Railways.*

P. W. D. Press—21-74—107.

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Govt. of 1874 Madras.
PUBLIC WORKS.

The Com. Engr.
for Mys.

Dated

Recd.

Encl.

G. O. 26 Aug. No. 2335

Nos. 590-591.

Funds (Railways). Nos. 2
The public India forwarding
copies of despatches on the
subject of the abolition
of ~~the~~ Fire Insurance
and General Reserve,
and other similar funds
in guaranteed Railways,
Comd. Wm. J. Engr.

Wm. J. Engr.