# PREFACE

In a bid to standardize higher education in the country, the University Grants Commission (UGC) has introduced Choice Based Credit System (CBCS) based on five types of courses *viz. core, discipline specific, generic elective, ability and skill enhancement* for graduate students of all programmes at Honours level. This brings in the semester pattern, which finds efficacy in sync with credit system, credit transfer, comprehensive continuous assessments and a graded pattern of evaluation. The objective is to offer learners ample flexibility to choose from a wide gamut of courses, as also to provide them lateral mobility between various educational institutions in the country where they can carry their acquired credits. I am happy to note that the University has been recently accredited by National Assessment and Accreditation Council of India (NAAC) with grade ‘‘A’’.

UGC (Open and Distance Learning Programmes and Online Programmes) Regulations, 2020 have mandated compliance with CBCS for UG programmes for all the HEIs in this mode. Welcoming this paradigm shift in higher education, Netaji Subhas Open University (NSOU) has resolved to adopt CBCS from the academic session 2021-22 at the Under Graduate Degree Programme level. The present syllabus, framed in the spirit of syllabi recommended by UGC, lays due stress on all aspects envisaged in the curricular framework of the apex body on higher education. It will be imparted to learners over the six semesters of the Programme.

Self Learning Materials (SLMs) are the mainstay of Student Support Services (SSS) of an Open University. From a logistic point of view, NSOU has embarked upon CBCS presently with SLMs in English / Bengali. Eventually, the English version SLMs will be translated into Bengali too, for the benefit of learners. As always, all of our teaching faculties contributed in this process. In addition to this we have also requisitioned the services of best academics in each domain in preparation of the new SLMs. I am sure they will be of commendable academic support. We look forward to proactive feedback from all stakeholders who will participate in the teaching-learning based on these study materials. It has been a very challenging task well executed, and I congratulate all concerned in the preparation of these SLMs.

I wish the venture a grand success.

**Professor (Dr.) Ranjan Chakrabarti**
Vice-Chancellor

Netaji Subhas Open University
Under Graduate Degree Programme
Choice Based Credit System (CBCS)
Subject : Honours in Public Administration (HPA)
Financial Administration
Course Code : CC-PA-10

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# Netaji Subhas Open University

## Under Graduate Degree Programme
## Choice Based Credit System (CBCS)
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# BLOCK I

# INTRODUCTION

## UNIT 1 NATURE AND SCOPE OF FINANCIAL ADMINISTRATION

### STRUCTURE

**1.1.Learning Objectives**

**1.2.Introduction**

**1.3.Nature of financial administration**

**1.3.1 Traditional view**

**1.3.2 Modern view**

**1.4.Scope of financial administration**

**1.5.Indian financial administration**

**1.6.Conclusion**

**1.7.Summary**

**1.8.Key words**

**1.9.Model questions**

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### 1.1 LEARNING OBJECTIVES

After going through this unit, you will be able to-

- Understand the meaning and nature of financial administration
- Discuss in detail the role of the Executive and the Legislature in financial administration
- Explain the significance of financial administration
- Understand the financial administration in India along with its various functionaries.
- Learn about the financial institutions and their role in driving the Indian economy forward.

### 1.2 INTRODUCTION

The term financial administration refers to certain rules and methods relating to revenue and expenditure be it any institution especially of meta nature. Financial administration is the crucial aspect of public administration because the running or management of administration is impossible without money or finance and for that reason financial administration occupies the centre of public administration. The task of public administration or government is to levy taxes and this job is uniquely performed by the legislature. But the executive organ cannot levy taxes beyond what is needed to keep the economy running and maintaining economic stability. Again, the executive will have to give explanation to the legislature for the money it has collected and spent under the norms of financial accountability so that no public money is defrauded from the public exchequer. Thus, in general terms financial administration simply includes the earning or collection of money and expenditure of the collected money for the economic growth and stability of the system and the nation.

When studied in detail though, the simpler explanations pave way for detailed nuanced and at times expansive meanings of the concept. One of which explanations takes the purview of institutionalism, stating that financial administration studies the role of the government in the economy. It is the definitive branch of economics which assesses the Government revenue and Government expenditure of the Public Authorities and the adjustment of one or the other to achieve desirable effects and avoid undesirable ones. In simpler terms the goal of financial administration is centred around creating stable economic situations for the benefit of the national economy based on public income and expenditure. It is a subject which has the distinction of intimate interaction between theory and practice. It acquires a meaning and usefulness only in the context of institutional framework of the economy based on economic structures that not only control but regulate the resources (in economic terms) of the country with reference to which it is being studied.

The theoretical concepts and policy applications in public finance feed upon and grow out of each other based upon a strong academic history of the realms of both public administration as well as economics. No single theoretical model can adequately fit in the framework of every economy since its institutional framework is a thing unique to itself across systems applied by various nation states. It is important, therefore, that the discussion of public finance should be in the context of a single economy as in this chapter it is based on Indian financial administration. When dealing with Indian financial administration we generally refer it as a part of public administration because of the reason that Indian economy is not a completely privatised economy, it has both the features of controlled as well as lenient market tendencies but the major control of the economy is under the Finance ministry of the Union Government of India.

Public financial administration has a direct influence on the overall quality of life of the masses. It is concerned with that part of the government which is action-oriented. Recent years have witnessed a heated debate on several theoretical and policy issues covering several segments of public finance, including the role of fiscal policy. Pleas are being made for a thorough restructuring of its various theoretical and policy premises and the framework within which these should be conducted. Exponential growth and transformation in global financial system and worldwide meltdown caused by it have fuelled rethinking on the role of fiscal policy with a special focus on economic stability and growth—both in developed and developing countries. India, like the rest of the world, has also been deeply affected by these developments. Recent changes in the tax regime under the GST reforms under the GST council has brought the single most effective change in the financial structure of the country. The larger impact of the policy change is still being studied. The administrative section of the government though has various long-term goals based on the current political economic situation of the global order.

## 1.3 NATURE OF FINANCIAL ADMINISTRATION

In general terms, financial administration implies administration relating to the management of collecting revenues and expenditure for running the public administration. There are various ways of collecting revenues such as levying taxes, borrowing money from public and financial institutions, collection of money for development works etc. Collection of money in any form is not all.

Since the government is a public organisation, it is legally bound to give explanation to the public for the money it collects from which source and in what way, and for what purposes it spends the money it collects. Here ties the planning for collecting money and spending it for various purposes. Both the income and expenditure are guided by plans or certain definite rules and regulations.

Majorly there are two different views regarding the nature of financial administration. In the classical differentiation of most public administrative terms these are –

### 1.3.1. Traditional view

Traditional view advocates to conceive financial administration as a sum total of activities undertaken in pursuit of generation, regulation and distribution of monetary resources needed for the sustenance and growth of public organisations by the state. They emphasise upon that set of administrative functions in a public organisation which relate to an arrangement of flow of funds as well as to regulating mechanisms and processes which ensure proper and productive utilisation of these funds for public good. When one looks at this view from systems perspective, it represents an integral sub-system of supportive system. A financial administrator shoulders responsibility for ensuring adequate financial backing for running public organisation in the most efficient manner which in the case of India is the Finance ministry. The participants of this system are considered as financial managers and they discharge managerial functions of financial nature (both political as well as professional). The central thesis of pure theory of public finance is that public finance should deal with the problems of public income, public expenditure and public debt in an objective manner without any relation to a set of values and premises of the political party in power. Accordingly, theorists of financial administration subscribing to this view take a value-neutral stand. For instance, Jaze Gaston reflects this view when he says that financial administration is that part of government organisation which deals with the collection, preservation and distribution of public funds. As in the case of India this view has been widely accepted as well as implemented.  The Financial Administration in India is a part of general administration. The purpose of Public Administration is to see that the money sanctioned by the legislature for development and other purposes is properly spent and the performance of the financial administration is quite satisfactory.

### 1.3.2. Modern view

The modem view considers financial administration as an-integral part of the overall management process of public organisations rather than one of raising and disbursing public funds. It includes all the activities of all persons engaged in public administration, for quite obviously almost every public official takes decisions which are bound to have some direct or indirect consequences of financial nature. Further, it rejects the value-neutral stand of the traditional theory. It combines in itself three prominent theories of public finance, viz., the socio-political theory as expounded by Wagner, Edgeworth and Pigou, the functional theory of Keynesian perspective and activating view of modem public finance theorists. Though Indian system had incorporated the Keynesian perspective for long the 1994 reforms and subsequent governments have brought in the modern public finance theorists who support a collaborative role for the government rather than a controlling role.

## 1.4. SCOPE OF FINANCIAL ADMINISTRATION

According to Gaston Jaze's definition, the government organisation deals with the following four aspects of financial administration. These include:

1) The collection, preservation and distribution of public funds.

2) The coordination of public revenues and expenditure.

3) The management of credit operations on behalf of the State.

4) The general control of the financial affairs of the government.

In modern governments all the above aspects are dealt with by the Finance Department and its subordinate agencies which include both the public representative section in the form of ministers inside a government as well as professional section based on meritocracy which comprises of the bureaucracy of the state. Though the Finance Department or the Finance Ministry may be considered as central financial agency of modem governments, it cannot be equated with financial administration. The ministry of the department’s role constitutes financial management rather than financial administration. As a financial manager it deals with the systems, tools and techniques contributing to economic decision making in government which are constituted in the form of various institutions such as departments, committees, councils and boards which are part of the holistic administrative process. These processes are, in fact, the integral part of financial administration of the country, but the scope of financial administration is much wider than what these processes suggest. Legal experts support the idea that financial administration refers to the financial processes and institutions involved in legislative financial control. In their view, the scope of financial administration encompasses the preparation of estimates, appropriation of funds, expenditure control, accounting, audit, reporting, review and so on. In a democratic context, this view may gain wider acceptance as it ensures executive responsibility to legislature. But, the experience of modem democracies has shown that the legislative involvement in the determination of the desired volume, range and direction of programmes, the use of independent judgement relating to the financial resources required by administrative agencies is becoming nominal day by day. It is a known fact that the average member of the legislature is not adequately informed to ensure effective control over executive. Thus, the view appears to be of no significant validity. Further, legislative control of financial aspects of the government does not represent the scope of financial administration in its entirety. Yet another view advocates a budget-oriented outline for the scope of financial administration. According to them the scope of financial administration is limited to the preparation of budget, the enactment of budget and execution of budget. Though the budget is the core of financial administration, certain operations which precede budget preparation are equally important. There is a pertinent need to include planning process as an integral part of financial administration. In the ultimate analysis, there is a need to adopt an integrated approach so that all the above views are incorporated into the scope of public administration. As an outcome of such an approach, the following aspects emerge as the core areas of financial administration.

i) Financial

In a restrictive sense one may consider budgeting as planning since its basic concern is to facilitate the formulation and adoption of policies and programmes with a view to achieving the goals of government. Financial planning includes the concerns in terms of whole range of government policy and it demands a time frame and a perception of the inter relationships among policies. It looks at a policy in the framework of long-term economic consequences started. The Planning commission of India was the pioneer institution of such planning in post independent India. Nehruvian influences though were found in abundance in the institution, many give the credit of the idea to Subhas Bose's proposals for post independent Indian economic rejuvenation. There is a need to coordinate planning and budgeting. The concept of planning-programming-. Budgeting System (PPBS) represents an attempt in this direction. Financial Administration, under this phase, considers the sources and forms of finance, forecasting expenditure needs, desirable fund flow patterns and so on.

ii) Budgeting

Budgeting is the core of any financial administration without which allocation, implementation and application of planning will go haywire. It includes examination and formulation of important aspects as fiscal policy, equity and social justice making it not only an economic factor but a socio economic one which has to bring a balance of objective realities with subjective distributive justice as well. It also deals with principles and practices associated with refinement of budgetary system and its operative processes as with new infrastructure the process of budgeting improves and attempts to cater to the needs of the hour for the society as well as the structure of state and economy.

iii) Resource mobilisation

Resource mobilisation is simply bringing in the resources together for creating mechanisms of economic planning. This process includes the imposition of taxes, collection of rates and taxes etc. These are associated with resource mobilisation effort tas a whole. Due to the ever-increasing commitments of government, budgetary deficits have become regular feature of government finance. In this context deficit financing assumes greater importance. But deficit financing, if used in an unrestrained manner, may prove to be a dangerous problem for a nation's economy for it can cause galloping inflation. This not only threatens the national economy but also puts immense pressure on the federative units with the nation state. Another challenge faced by administration is tax evasion and growth of parallel economy namely the illegal ways of defrauding public money in the form of stashing money in offshore accounts, hawala transactions and black marketing of public goods and services to harm the mainstream and finance destructive elements. Finally public debt constitutes yet another element of state resources. The recent case of Sri Lanka is a pertinent example of how uncontrolled public debt can lead to uncontrollable inflation which may derail the economy of nation and cause massive public dissatisfaction. The proceeds of debt mobilisation effort should be used only for capital financing. Thus, modem financial administrator has to be fully conversant with all the dimensions of resource mobilisation efforts

iv) Investment decisions

investments are a huge part of public expenditure especially in the case of a huge and diverse nation such as India. Funding for social welfare programmes as well as infrastructural investments require huge investments from the government. Since massive investments have been made in the public sector, a thorough knowledge of the concepts, techniques and methodology of project appraisal is indispensable for a financial administrator. The investment initiatives require close monitoring and are therefore a very important facet of financial administration.

v) Expenditure control

Modern governments have a huge expenditure responsibility. The coordination of such finances is as important as control over such expenditure, in absence of which wastefulness increases and harms the public exchequer greatly. Finances of the modem governments are becoming quite inelastic. Almost every government is suffering from resource crunch. Further, the society cannot be taxed beyond a certain point without doing a great damage to the economy as a whole. Thus, there is an imperative need for careful utilisation of resources to avoid wastage and financial drain of public money. Executive control is a process aimed at achieving this ideal. Legislative control is aimed at the protection of the individual tax payers' interest as well as public interest. There is also the need to ensure the accountability of the executive to the legislature.

vi) Accounting, Reporting and Auditing

Accountability forms an important feature of not only public administration but any modern democracy. Without checks and balances any system is susceptible to corruption and crumble.

Accounting for the money utilised, reporting of utilisation and discrepancies and auditing in case of questions of misappropriation, misutilisation, misgovernance create the trio of accountability measures under financial administration. These aspects are designed to aid both the executive control and legislative control. In India, the Comptroller and Auditor General (C & AG) and the Indian Audit and Accounts Department over which the C & AG presides ensure that the accounting and audit functions are performed in accordance with the provisions of the Constitution. Comptroller and Auditor General of India controls the entire financial system of the country at the Union and as well at the state levels.

### 1.5. INDIAN FINANCIAL ADMINISTARTION

The government of India is the authority that looks after the totality of public exchequer's assets in the economy. The financial administration in India is a system of institutions that controls all the above-mentioned functions requisite for stabilised functioning of the economy. Financial administration in India is a dynamic process that involves various institutions and comprise of an on-going chain of operations, performed by the following agencies:

i. The Executive (primarily the Finance Ministry), which needs funds for allocation and monitoring.

ii. The Legislature, which alone can grant funds for various projects at a national level comprising of both the government and the opposition in the parliament.

iii. The Finance Commission.

iv. The Indian Audit and Accounts Department.

v. The Parliamentary Committees.

The executive powers of the central government have been vested in the President, to be exercised by him or her either directly or through officers' subordinate to him or her, in accordance with the Constitution (Article 53). The Finance Ministry is an important ministry within the Government of India. It is the leading state administration institution in the field of finances. It develops financial policy, coordinates and organizes its implementation, as well as performs other functions stated in the external regulatory enactments. India has a parliamentary form of government. Our Parliament or the Union Legislature, the supreme legislative body in the country, comprises two Houses— Lok Sabha (House of the People) and Rajya Sabha (Council of States).

The main function of both the Houses of parliament is to pass laws. The law proposal originates in the Parliament in the form of a bill. There are four types of bills that come up before the Parliament, namely ordinary or nonmoney bill, money bill, constitution amendment bill and budget. Of these four types of bills, money bill and budget pertain to financial administration. Article 110 clearly defines what constitutes a 'money bill'. The Speaker of the Lok Sabha certifies whether a bill is a 'money bill' or a non-money bill. Money bill can be introduced, only along with the prior recommendation of the President, in the Lok Sabha and not in the Rajya Sabha. The Rajya Sabha cannot reject the money bill. It can only make recommendations.

Budgeting serves as a powerful tool of coordination. Its ends are served by devices, such as, justification of estimates, supervision of the use of appropriated funds, timing of the rate of expenditures, and the like. It inculcates, or should inculcate, cost-consciousness and this feeling should permeate all levels of administration including the operating level. Budgeting presents an opportunity for evaluating programmes and policies, thereby identifying obsolete or unnecessary activities and giving a call for their discontinuance. Every year, the Indian budget is presented before Its lower chamber in the parliament i.e., the Lok Sabha. The Finance Ministry under the government of India prepares the budget in accordance with the various functionaries including the political (ministers) and the professional (bureaucrats). The budget pre 2017 was presented in two parts:

(a) Railway Budget

(b) General Budget.

Railway budget was presented by the railway minister while the general budget is presented by the Finance Minister. The budget passes through various stages in both the houses of the parliament.
In 2017, the Railway Budget was merged with the Union Budget, ending a practice that began in 1924 under the British. A NITI Aayog commission submitted a white paper recommendation to do away

with the practice. The recommendation was submitted to then Railway Minister Suresh Prabhu and passed by the minister. The merger offered more elbow-room to the finance ministry for better allocation of resources. “It also facilitated multi-modal transport planning between railways, inland waterways, and highways.” However, then finance minister Arun Jaitley had mentioned that "the functional autonomy of railways will be maintained."

The financial administration is very significant aspect of public administration because the running or management of administration is not possible without money or finance and for that reason the financial administration occupies the centre of public administration. The Ministry of Finance concerns itself with taxation, financial legislation, financial institutions, capital markets, centre and state finances, and the Union Budget. The Union Finance Ministry of India comprises five departments—

i. Department of Economic Affairs

ii. Department of Expenditure

iii. Department Financial Administration of Revenue

iv. Department of Financial Services

v. Department of Disinvestments.

## 1.6 CONCLUSION

Financial administration has become a crucial component of modern nation states. Economic logic dictates that without monetary exchange of some form or the other the existence of stable political system is untenable at best. All societies thus have their financial administrative systems as an integral component of its public administrative system today. In contemporary India, financial administration began to assume the multifaceted role in order to secure maximum human welfare based on not only the needs of the society created post 1947 but the society that existed in continuum pre-1947. Financial administration, in its evolutionary process, has proved to be, a dynamic entity capable of developing itself into a potential measure to meet requirements of changing socio-economic demands from time to time. The comprehensive bureaucratic order maintained under the government of India and its various functionaries have kept the financial administration of India at par with the demands of the society for development as well as the international order for maintaining cordial economic ties of trade and finance without jeopardizing the economic structure of the state or of the aspirations of the people. Of late, financial administration has assumed the role of a provider of choices with regard to ends and means as major changes have been brought about by the requisite institutions. As discussed, its scope is expanding day by day and at present it encompasses many dynamic aspects which are ushering new changes not only in the national context but international as well. Examples may include conventional attributes such as financing, planning and budgeting, resource mobilisation as well as newer avenues of joint public private investment, public expenditure based on decentralisation of both powers and responsibilities, control including financial control etc.

## 1.7 SUMMARY

- Financial administration is an important facet of modern-day public administration. It concerns itself with the monetary affairs of the state and public money.
- There are various ways on how one views financial administration, there are traditional views of holistic subjectivity as well as the modern view of distributive or federative objectivity.
- In India financial administration is a structural process encompassing the both the legislative and the executive of the state in being a part of planning, budgeting, investment, policy making, policy review as well as accountability measures.
- With the change of time, financial administration has become more dynamic, people responsive and cooperative. India's shift from Planning commission to NITI Aayog is an example of such a shift.

## 1.8 KEY WORDS

- **Audit**: It is an objective examination and evaluation of the financial statements to make sure that the financial records are fair and accurate.

- **Subsidies**: It is a benefit given to an individual, business, or institution, usually by the government. It is usually in the form of a cash payment or a tax reduction.
- **Laissez Faire**: Non-interference policy of the government in economic affairs.
- **Budget**: It is an estimation of revenue and expenses over a specified future period of time and is utilized by governments, businesses, and individuals. A budget is basically a financial plan for a defined period.
- **Zero-based budgeting**: It is a method of budgeting in which all expenses must be justified for each new period.
- **Planned economy**: An economy in which production, investment, prices, and incomes are determined centrally by the government.

## 1.9 MODEL QUESTIONS

### Short questions

- What are the financial powers of the President of India?
- What is the role of the legislature in the financial administration of the country?
- Write a short note on the bills that pertain to financial administration.

### Medium question

- What is a vote on account?
- Write the functions of the Comptroller and Auditor General of India?
- Financial administration is the backbone of any country- Explain

### Long questions

- Discuss the functions of the Finance Ministry.
- Examine the significance of financial administration.
- Discuss why the financial administration is considered the centre of public administration?

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## UNIT 2 OBJECTIVES AND PRINCIPLES OF FINANCIAL ADMINISTRATION

### STRUCTURE

**2.1.Learning Objectives**
**2.2.Introduction**
**2.3.Objectives of financial administration**
**2.4.Principles of financial administration**
**2.5.Conclusion**
**2.6.Summary**
**2.7.Key words**
**2.8.Model questions**
**2.9.References**

## 2.1 LEARNING OBJECTIVES

After going through this unit, one will be able to-

- Discuss the goals of fiscal policies of governments aimed at securing certain socio-economic welfare as judged and decided under the aegis of public policies
- Describe ways and means as well as appropriate institutional instruments to secure an understanding about how fiscal policies create situations for achieving public policy-oriented goals.
- Explain how the Indian financial administration has done in formulation and execution of fiscal measures through certain fiscal institutions and processes over the years.
- Highlight the economic trends and their usefulness in facing contemporary challenges especially by India.
- Discuss the need to comprehend various aspects of financial administration as a way out to consider contemporary socio-economic problems and the solutions therefor.

## 2.2 INTRODUCTION

Any form of administration is only as strong as the principles it stands upon and functions upon and the objectives it seeks to achieve for the larger good. Since the industrial age, governments have played the role of an arbitrator to ensure that market forces aren't hindered in their goal for liberalised trade. Governments have had a single objective of affording protection to the basic socio-economic framework of the system and providing a shield from hostile forces threatening the system from inside as well as outside. In this context, financial administration supported the concept of judicious use of public money without wastage for public welfare with minimum harm to the market structure as its goal. The regulatory and welfare functions to the sphere of government which includes security, law enforcement and health have been added to the functional role of financial administration. It has been supported and articulated in terms of mobilisation of resources and their productive deployment for public good and protection of state. It was expected to achieve the broad objectives spelled out in public policies from time to time with the aim to achieve the objectives of the government with the maximum possible level of efficiency at the least expenditure, the very crux of Lockean liberalism thus was expounder under such a system. Though there is has been no universal agreement about ends of the State which range for mobilisation for self-preservation to safeguarding basic human requirements to the creation of a welfare state with a commitment to socio-economic equity wishing to raise the quality of life of its citizens in preference to military conflict-based expansion as espoused by the lebensraum theory of Adolf Hitler. There cannot be a single set of universal truth-based objectives, other than efficiency and economy, which can be visualised by a student of financial administration. Though situational objectives based in terms of certain common targets pursued by financial administration can be found all over the world when one looks at the experiences of the governments throughout the world, such an exercise doesn't help in providing a concrete prescription of a set of objectives. The goal thus is not to get a solution for every system but to analyse the intricacies that make each system/state different and unique and provide objectives that can be reached based on common minimums for ushering economic growth under a stable and competent financial administration.

## 2.3 OBJECTIVES OF FINANCIAL ADMINISTRATION

The unpredictability of capitalist forces of the modern market in the developed countries, have led to an enlarged scope of financial administration. This system has been largely characterised by deficit budgets, massive public debt and deficit financing. Despite all this these features have been the backbone of modern democratic structures where excess public funding is a rarity and social welfare a necessity. Similarly, in the developing countries, where governments have assumed the role of a facilitator of development, fiscal policies and administration embark upon a set of multiple objectives. These are targeted to bring in stability, development, self-reliance, reduction of interpersonal inequalities in income and wealth, and balanced regional development. These countries also utilise the same instruments of action to achieve the above-mentioned goals. There are certain fundamental objectives of financial administration which transcend, politico-economic compulsions. Even though political ideologies, or economic doctrines create the necessary situations for functioning of the state it is the fundamental objectives that provide long term basis for economic stability as well as development of nation and the continuance of its system. These are as follows:

1) **Management of finances of the Public**: Public authorities are concerned with the satisfaction of human wants and their major problem is to ensure the best application to secure given ends with limited resources at their disposal. In this context, the focus is to be on structured mobilisation of resources and their rational deployment, which must be in conformity with the rising expectations of the people.

2) **Implementation of projects and programmes**: An important facet of 21st century financial administration coming from 20th century itself is related to ensuring optimal public investment. This has to be maintained through decisions based on project formulation, appraisal and implementation. The emphasis has shifted from expenditure control to the implementation of projects within the stipulated time schedule and expenditure limitations.

3) **Provision for public goods and social services**: Since the benefits from public goods and social goods are available to everyone in the society. The goods are provided to every one irrespective of one's contribution to public exchequer. So, the system maintains that no one will offer payments for the supply of such goods. Provision of public goods like public parks, social services like public health, sanitation cannot be left to the private sector which is motivated by profit rather than service to the people. Budgetary support for such services become a valid concern for fiscal policy makers.

4) **Growth, Employment and Price Stability**: Modem governments tend to focus their attention on socially desired rate of economic growth, high employment and a reasonable degree of price level stability and a positive balance of payments position. Achievement of these objectives cannot come about automatically and thus, there is always a need for policy initiatives on the part of public authorities to ensure the fulfilment of such objectives.

5) **Capital Formation**: Economic development of a nation, largely depends upon the capital formation. This goal is achieved through increased savings of both the populace and the government. Despite this there is no evidence that supports the idea that any amount of State's coercive power can

achieve this objective. Appropriate financial and fiscal measures such as discriminatory taxation and monetary policy instruments are necessary requisites to accomplish this objective.

6) **Productive deployment of funds**: A major problem of under-developed countries is the allocation of required funds between competing projects and programmes. Deployment of funds is thus a crucial factor in judicious use of public money. In order to ensure flow of investible funds into desirable channels proper mechanisms are a necessity. For this goal various organisations in different systems lays down guidelines regarding priorities for different types of investment for both public as well as private sector. The finance ministry in India takes up the task of ensuring adherence to national priorities both in the public sector and the private sector.

7) **Facilitating smooth flow of parliamentary processes**: The basic tenet of and objective representative governments throughout the world is the supremacy of the representative institutions. Any democracy can only function smoothy with public representation based on universal adult suffrage which in turn tends to provide legitimacy and exert their control over executive branch of the government. One of the most important dimensions of this is the control of legislature over use of public funds. Financial administration through its budgetary process and audit function enables and ensures the supremacy of the legislative body over the executive.

8) **Achievement of equity and equality**: The distribution of income and wealth depends upon the distribution of factors of production and factor pricing determined through the market mechanism. It also depends upon the transmission of property rights through inheritance as well as personal earning abilities. Such distribution may not be in conformity with what society considers a "fair" or "just" state of distribution. Equity, however, has to be achieved through an evolutionary process without giving scope for class conflicts and large-scale violence. There should be a progressive reduction in the concentration of economic power. At the same time, equal opportunities for every one in every sphere will have to ensure non-occurrence of fresh inequalities. Financial administration, through its fiscal policies, such -as progressive taxation; grants, subsidies etc. can help movement towards greater equality of wealth and opportunities.

## 2.4 PRINCIPLES OF FINANCIAL ADMINISTRATION

### 1) The principle of primacy of public interest, public choice and public policy

Public interest is the prime factor that determines financial administration as a whole. Public interest can be interpreted in various ways such as the common good, the general welfare, the overall quality of life of people as individual and society as a collective. In simpler terms the collective realisation of social values, rights and privileges is a necessary to conduct smooth functioning of financial administration in a state. The need for any responsible administration is to concentrate on those types of activities which make a definite and justifiable contribution to the accomplishment of public interest and public satisfaction that can be expressed in the implementation of public policies. It is quite essential to realise that financial policy is expected to meet the broad aims as spelt out in public policies. One should be clear about the meaning of public choice as public choice is a choice which encompasses common life and is shared by all.

### 2) **The principle of political direction and control**

The politico-legal framework of a state is of great importance for conditioning of both public and private activities. This structure is found in basic laws of the land and in prevailing customs, conventions and traditions by which political ideals and ideas exist and develop within a system. Financial administration, as a subsystem of public administration, should agree to these political ideas and ideals as expressed through the constitutional process of the society. Further, there is always a need to adjust financial administration to the political structure of a particular society to which it is attached. In the 21st century, most countries have accepted democratic ideas and ideals and have replaced all the previous structures and ideals. Therefore, the system of financial administration is to be organised and operated in a manner so as to secure compliance with the will of legislature as expressed through the various democratic statuettes enshrined. These may include laws such as - Appropriation Act, the Finance Act and other policy devices. The nature of these laws is both public and fiscal. In order to ensure its control over financial administration of the executive government, the legislature (parliament) takes an account of financial functions through an independent audit organisation like the C & AG in India.

2) **The Principle of Correspondence**

This principle suggests a causal relationship between the objectives of financial administration and the functions of the administration. In simpler terms, the human and material resources necessary to accomplish such objectives must have a flexible yet strong correspondence between them. The type of functions, the personnel required to handle them and the physical facilities necessary for the purpose should have a rational mutual interrelationship. The objectives and the functions should provide the basis for staffing and equipping of the financial organisation to serve the people in a better manner which respects the democratic rational system of the present order.

4). **The Principle of Unity of Organisation and Management and Objectives**

Unity of organisation is the source of strength for any organisation be it private or public. Most thinkers of public administration link this principle to centralisation-based efficiency. While it should not be taken to mean centralisation of every minute detail at the top of hierarchy but it does mean that the work is coordinated between the different financial and non-financial agencies and highly evaluated by the top officials of the government. Experiences of developing countries have exposed the inadequacy of centralised decision making that had followed conservative protection of domestic markets based on centralised planning post 2nd World War. The most widespread tenet of financial administration today revolves around the facet of centralised direction and decentralised decision making and decision implementation. The concept of administrative financial control has slowly given way to the concept of management of results. This principle supports centralised guidance for facilitating decentralised decision making with a view to securing maximum production (quantity) as well as optimum utility (quality). The concept of national planning of various developing countries can be taken as an example of such ideal.

5) **The principle of stability and balance**

Any system to function at its optimum requires stability and balance between its functioning units as well as constituting units. The feature is maintained by recruitment of regularised and trained personnel. There is also a requirement to have a backup force to maintain the stability of the administration and thus, this principle calls upon financial organisations to not only recruit and maintain a stable order of personnel but develop capacity to withstand losses of specific trained personnel without serious consequences to effectiveness, and efficiency. For this purpose, there is need for effective-manpower planning together with a good programme for human resource development.

6) **The principle of simplicity and flexibility**

The 21st century is the century of democracy with most countries shifting to democratic forms of government based on popular mandate of the people. People become the core of democratic sovereignty in all such countries. All other democratic institutions, including parliament, derive their authority from the people. Therefore, it is very essential that the financial system and its procedures should be simplified in such a manner so as to become accessible to the commonfolk. If this principle is implemented properly, it can reduce cost and economise the system to a great extent. The principle of flexibility implies that the financial organisation should develop capacity to adjust itself. to fluctuations on work flows, human compositions and physical facilities.

7) **The principle of conduct, discipline and regularity**

The officials of public financial organisations are supposed to act ethically and set high ethical standards as they are the custodians of public money and keep the system working flawlessly. Income tax officials as sentries to keep public money safe could be very effective in preventing tax evasion by setting ethical examples themselves by their on-field actions. The principle of discipline implies that the objectives, rules and regulations, the policies, procedures and programmes must be honoured by each and every member of a public financial organisation. Any financial organisation can only function effectively with a strict structure of firm financial discipline. What is needed is voluntary or self-discipline to reach desired goals. The principle of regularity implies that no financial organisation, can afford to function at intervals. It’s a continuous process of administration that makes it competent and thus must be maintained diligently.

8) **The principle of Public Trust and Accountability**

The responsibility of any financial administration is to collect and disburse public funds as a public trust. But as alike any other system it is never full proof and susceptible to malpractice making it quite vulnerable and which in turn can lead to misuse of these funds for personal interest. Financial administration has therefore to be held publicly answerable for proper use of funds at several levels such as political, legal, administrative, organisational, professional, moral and aspirational. Here accountability implies answerability for one's responsibility and for trust bestowed in an official. Crimes are to be punished by dismissal and redressal of requisite nature.

## 2.5 CONCLUSION

Over the years the functional role of financial administration has undergone a major change. It has come to be viewed in terms of mobilisation of resources and their productive deployment of the same to engage public funds for the benefit of the larger masses in an equitable manner. Any form of financial administration is expected to subserve the broad objectives specified in public policies of a given time, there remains certain fundamental objectives which are pursued by financial administrators to maximise the output from the system without endangering it partially or wholly. As is evident from the experience of developed and underdeveloped countries, in the unit, management of the finances of public funds, facilitation of economic growth of the country, ensuring full employment of the populace, price stability of commodities in the domestic market and equitable distribution of wealth between the people are some of the important objectives of financial administration. Cultural diversities impede the system to lay down universal principles of financial administration but their existence in some form or the other is universally accepted. However, based upon the experience in international and inter-cultural contexts, it can be inferred certain principles to serve as broad guidelines. These include, primacy of public policy and political direction and control; unity of organisation and management; correspondence among objectives, functions and resources; stability; simplicity; balance and flexibility etc. Financial administration in India reached an advanced position from as early as 4th century B.C as mentioned under Kautilya’s Arthshastra to the leeway provided by the Narsimha Rao government in the early 1990’s. There is much in the fiscal history of India that one can feel proud of. A beginning has been made to establish modern system of financial administration during British period and the post independent developmental model supported by a people responsive financial administration has provided Indian democracy to function in a manner which is unique in South Asian countries.

## 2.6 SUMMARY

- Financial administration is dynamic affair and has undergone many changes since the inception of nation state and its functionaries.
- Every potent system must have certain principles on which its groundings are based upon and provide the structural strength to the system.
- The goals of financial administration are to be people oriented, structures, regulated, and maintained by a professionally trained personnel system of officers who are of high moral fabric in execution of duties to execute public good based on policies mandated by government and stop any form of misappropriation.
- Financial administration has to be held publicly accountable and thus has to be answerable to the electorate for proper use of funds at several levels such as political, legal, administrative, organisational, professional for economic democracy to sustain itself in a nation.

## 2.7 KEY WORDS

- **Capital-** an amount of money that you use to start a business or to put in a bank, etc. so that you earn more money (interest) on it.
- **Subsystem-** a self-contained system within a larger system.
- **Equity-** the quality of being fair and impartial.
- **Personnel**- the people who work for a large organization.
- **Exchequer-** the government department that receives and gives out public money, in the UK and some other countries

## 2.8 MODEL QUESTIONS

**Short questions**

- Explain capital formation?
- Why discipline is a central tenet of any administrative force/personnel?

- Explain the principle of trust and accountability?
- What is Comptroller and Auditor General?

**Medium questions**

- Explain the Principle of Unity of Organisation and Management and Objectives?
- Mention the 8 objectives of financial administration?
- What are the budgetary concepts which are to be kept in mind while engaging in planning of finances?

**Long questions**

- What are the budgetary concepts which have found their way into Indian economic reforms package?
- Explain how financial administration has changed post economic liberalisation in India?
- Explain the goals and mechanisms for ensuring accountability in financial administration?

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# UNIT 3 SIGNIFICANCE OF FINANCIAL ADMINISTRATION

## STRUCTURE

**3.1.Learning Objectives**
**3.2.Introduction**
**3.3.Significance of Financial Administration**
**3.4.Independent India’s financial administration**
**3.5.Conclusion**
**3.6.Summary**
**3.7.Key words**
**3.8.Model questions**
**3.9.References**

## 3.1. LEARNING OBJECTIVES

After going through this unit, one will be able to-

- Discuss the significance of financial administration in a country.
- Learn about how financial administration impacts the economy of any nation.
- Learn the various ways of how financial stability enhances a nation’s bureaucratic standing.
- Enhance the outlook already provided in earlier chapters and create a encourage to think critically about financial administrative measures.

## 3.2. INTRODUCTION

Modern day capitalism is centred around market policies structured inherently in money transaction controlled and coordinated by both national and international institutions. This system is based around the goal of maximising profit on neoliberal grounds. Most democracies in the world today have accepted the above-mentioned system to create stable national economies, create jobs, balance fiscal policy and participate in international trade. In order to sustain such a comprehensively complex structure a system of coordinated personnel is a must to be kept at all the requisite institutions. Private institutions are more entrenched in profit creation processes and thus susceptible to vulnerabilities. Such vulnerabilities have harmed the present economic structure many times, the biggest of which were the crash of 1930's and the crash of 2008. National economies cannot afford to be hit in such a manner. National governments aren't spenders of public money but rather trustees of public money. Using the said money for profit seeking is risky and detrimental to the national exchequer. This may lead to financial crash, inflation, budgetary decline, stagflation and even bankruptcy. To avoid all such dangerous circumstances national governments in most democracies, tend to have an established institutionalisation of financial administration within the larger ambit of public administration which is simply called bureaucracy. Such an administration works with a professional personnel force to look after the due processes related with public finance. This administration formulates polices for better management of national finances and to create and regulate structures to lead national economic growth, stabilised business atmosphere. The principles and goals of financial administration is centred around creating strong economic structures, tangible economic relationships, stable markets, avert economic blunders, stop misappropriation, regulate inflow and outflow, create accountability and implement public policy for public good and enhancing the country's economic standing nationally as well as globally. Democracies favour such structures immensely and thus are rendered to public representatives for insight, oversight and formulation with the professional bureaucracy looking after the on-field implementation and review of the policies passed in the legislature. The significance of such an organisation is immense both theoretically and practically. The unit discusses how this significance is expressed in modern day democracies with pertinent examples from the Indian financial administration.

## 3.3. SIGNIFICANCE

The significance of financial administration in any nation is entrenched not only in its functioning but in the constitution as well. Most modern democracies have a clear mention of how finances of the state are to be maintained and looked after by various agencies and the agencies are given constitutional mandate to perform such duties. The significance of financial administration can be discussed under the following heads:

**Success of Promotion Depends on Financial Administration**.

Financial planning is of utmost importance to any well-established order. It is through this planning that any stable authority decides upon how to spend its finances over a specific period of time. Promotion of businesses in a nation requires intricate planning of investment into the ventures and thus takes the effort of a well-oiled machinery under an adept financial administrator. One of the most important reasons of failures of business promotions is a defective financial plan. If the plan adopted fails to provide sufficient money to meet the requirement of fixed aspirations or it fails to assume the obligations by the corporations without establishing earning power, the business cannot be carried on successfully. Hence sound financial plan is very necessary for the success of any economic enterprise.

**Smooth Running of an Enterprise**.

Any national economy requires an unencumbered and stable functioning of its subsidiaries. National economy is the largest enterprise that a financial administration takes care of. The decisions taken by such an administration is of national importance. Sound financial planning is therefore necessary for the smooth running of such an enterprise especially when it is considered with public money. Money is to an economy what oil is to an engine. As finance is required at each stage of an enterprise undertaken by the government which starts from basic policy formulation to promotion, incorporation, development, expansion and administration of day-to-day working etc., a smooth-running machinery is a must to keep the system functioning and being responsive to the demands of the national and international economy working. To meet all such demands a proper administration of finance is very necessary.

Proper financial administration means the study, analysis and evaluation of all financial problems to be faced by the management and to take proper decision with reference to the present circumstances in regard to the procurement and utilization of funds.

**Financial Administration Coordinates Various Functional Activities.**

Financial administration provides complete coordination between various functional areas such as policy promotion, implementation as well as creating a feedback loop. to achieve the organizational goals. If financial management is defective, the efficiency of all other departments can, in no way, be maintained. As already mentioned, finance is the core of any administration functioning (oil to an engine) and other arms of the system are only as good as the financing done to them for implementation of respective policies.

For example, the salaries of public officials are paid under the consolidated fund of India according to Indian laws, the allocation done accordingly by the finance department which revises it every year depending on the situation of the economy. This keeps the bureaucracy functional and active at work as regular payments means a safe work culture and subsequently an active bureaucracy keep the system running smoothly. The disbursement though isn’t done by the finance department it is the coordinating authority between various public functionaries as in this case the public personnel department is with the finance department. Thus, financial administration occupies a central place in the organization which controls and coordinates all other activities in the concern of monetary matters.

**Focal Point of Decision-Making**.

No administration can function with haphazard work culture especially in the public sector. Public finance therefore is not a department that can be toyed or put through difficulties as the fate of a population and economic tidings of country lies with it. Financial administration thus needs to be a system capable of being objective in its approach, realistic about its goals and competent at its functioning to meet its desired goals. Financial administration provides scientific analysis of all facts and figures through various financial tools, such as different financial statements, budgets etc., which help in evaluating the effectiveness of the plan in the given circumstances, so that a proper decision can be taken to minimize the risk involved in the plan. This creates a system of responsible decision making under the administration which provides a holistic overview of the machinations required to keep the system functioning.

**Determinant of Success**.

It has been recognized, even in India that the financial administrators play a very important role in the success of the national economic structure by advising the top legislative units as well as the top executive units of which they are a part. They are the ones that provide the solutions of the various financial problems as experts. They present important facts and figures regarding financial position on the performance of various functionaries of the government in a given period before the competent authority in such a way so as to make it easier for the authorities to evaluate the progress of the departments concerned to amend suitably the principles and policies of the department concerned.

The financial administration in the form of the finance ministry assists the government in its decision-making process by suggesting the best possible alternative out of the various alternatives of the problem available on grounds of policies. Hence, financial management helps the government at different levels in taking financial decisions that are to benefit the country as whole.

**Measure of Performance**.

The performance of the government can be measured by its financial results, by determining the value of the economy in various quarters of a financial years based on various standards such as GDP (Gross domestic product), GNP (Gross national product), FDI (Foreign direct investment), total exports and imports, increase of foreign exchange reserves etc. Financial decisions therefore are finally determined to be success or failure based on the review on performance, which again is a function of the financial administrators. The budget presented every year isn’t only a planning mechanism for future but also acts as retrospective instrument explaining what changes are to be brought on based on last year’s policies. Therefore, financial administration is of paramount importance because not only for the present and future but also for the past.

## 3.4. INDEPENDENT INDIA’S FINANCIAL ADMINISTRATION

It was in 1947 that India broke the shackles of socio-political as well as economic dependence from the colonial powers. Independence brought basic changes in the political context of financial administration. The principle of executive responsibility to the legislature was formalised extensively. The budgetary and other systems and procedures were tuned to subserve this principle and its implementation. The institutions that were created to monitor monetary policy with the legislature were called legislative committees. These legislative committees began taking an active interest in the form, content, legality and regularity of public spending as office bearers and guardians of public money. One of the most crucial functionaries created was the position of Comptroller and Auditor General of India, an office created to enshrine and implement the principle of public accountability on various institutions of the government both at the centre and at the states. The Comptroller and Auditor-General became a constitutional authority with a responsibility to aid legislative control and exercise accountability measures regarding utilisation of public money. The financial administration gradually shifted its focus from stability to welfare of the people, development and equity of the country and the populace as a whole. Planning and Budgeting got united in the form of Performance Budgeting in 1974 which gave result orientation to financial processes. The system of financial control has been basically restructured so as to make it an instrument of plan implementation. Significant powers were delegated to various departments requiring budgetary allocation for implantation of public policies through various delegation schemes such as the schemes of 1955, 1958, 1962, 1968 and 1975. The responsibility for financial control was thus rendered to such departments that require money for implementation of policies and achieves the same by investment, procurement and other methods. This was broadly achieved by two means-

First one was the scheme of Integrated Financial Advice and the second was the separation of audit and accounts. In order to meet the growing financial needs of development expenditure, budget became an instrument of resource mobilisation. Consequently, several steps were taken to rationalise tax structure. Various mechanisms were drawn up to assist the process some of the prominent ones were the Kaldor's tax proposals, Wanchoo Committee Report, Jha Committee Report.

1. Jha Committee: The Indirect Taxa- Enquiry Committee was constituted by the Government of India under the chairmanship of L.K. Jha in 1974. It was set up with the objectives of examining the role of indirect taxation in promoting economic use of scarce resources, in mobilising, its impact on prices and costs and to suggest suitable reforms in the indirect taxation system.
2. Wanchoo Committee: The Direct taxes Enquiry Committee set up by the Government of India in 1970 under chairmanship of Mr. Justice R.N. Wanchoo. The Committee was to

recommend concrete, effective measures for unearthing black money, checking avoidance of tax, suggest improvements in tax assessment and administration

These initiatives stand out as instances to rationalise the public expenses of the country and suggest changes to make taxation policies more coordinated to help the organisations enhance management of public finances. Deficit finance became a regular feature as the government. The government had to bear costs of various welfare schemes to propel development of the country based on enhancing the capabilities of the population. Nationalisation of banking system was considered as an instrument to channel national funds towards development activities. Financial administration thus too a major burden of helping the country achieve its developmental goals with budget deficits especially from the public sector. The public sector in turn assumed significant importance in advancing the goals of development and equity as investment increased in this sector rapidly. The financial administration thus took on a massive rejuvenation for a newly decolonised country and though the successes of stabilisation, regularity, efficiency, equity was visible, as with every form of bureaucratic order, there were certain undesirable consequences. Galloping inflation, sinking balance of payments position, increasing negative returns from public sector, shrinking public savings and resource base etc. have made some negative impact on the overall picture of Indian economy. These problems have had a cumulative impact on financial administration in such a way that the government had to take steps to set right these tendencies, which again stands testament to the fact that the efficiency of financial administration in India is not only in its active role of maintaining the cohesiveness of Indian financial structure but also learning from the negative impacts of certain policies and reacting to those in a manner that shows the administration is learning with every step.

## 3.5. CONCLUSION

To sum up, financial administration isn’t only about its goals and principles and how it functions, it is also about why it is necessary in the modern system. Any form of public administration is as good as its financial resources without which its nothing but a sitting duck susceptible to the fluctuations of the market vulnerabilities and collapse. At every level from policy formulation to implementation to feedback and reaction based on the feedback the financial administrators perform functions are at most times unfathomable to the common masses, but it is these functions that keep the lowest and highest institution within the system functioning in a manner that enhances growth, welfare, safety, balance and above all freedom. In India the function undertaken by the Finance ministry does all these and much more to keep the national exchequer safe from volatile and destructive consequences. Considering the 70+ years of our independence with only minor shocks that have rattled the national economy, it can be safely assumed that the financial administration of India has been functioning responsibly using the public money judiciously and creating a system where growth is supported holistically and in an unencumbered way.

## 3.6. SUMMARY

- Financial administration is not only about goal achievement but also about how the process re-energises the system to keep performing in a cohesive manner.
- Every department in a government is centred around the finance provided by the financial administration which allocates money based on budgetary requirements. There is a necessity of different departments to coordinate amongst themselves to keep the process of public financing active and also create a feedback system where if problems faced during implementation, corrective measures could be taken.
- The significance of financial administration isn’t limited to performance but also keeping public finance safe, the system responsive to change and correction after getting feedback upon completion of government projects related to funding.
- Indian administration has gone from decolonised dependent system to a centralised independent one over the course of 70 years. The most recent change has been the deregulation of powers and decentralisation of responsibilities to be more people oriented and create processes that enhance public faith.
- The Wanchoo Committee and the Jha Committee have tried to bring in major taxation changes in the system to keep it functioning in a people-oriented manner and stopping it from becoming a slow centralising authority.

- The Finance ministry does all the primary functions to keep the national exchequer safe from volatile and destructive consequences and assist in contributing to the overall development of the country in financial matters directly and helping in other situations indirectly.

## 3.7. KEY WORDS

- **Unencumbered-** Not slowed down, or retarded; free to move, advance, or go forward.
- **Vulnerability-** The condition of needing supportive or protective social services and community resources.
- **Testament-** Evidence of a structured and resolute manner.
- **Cumulative-** Formed by or resulting from accumulation or the addition of successive parts or elements.
- **Inflation-** A persistent, substantial rise in the general level of prices related to an increase in the volume of money and resulting in the loss of value of currency.
- **Sitting duck-** Prone to attack in a situation of being incapable to act or respond in a situation
- **Decolonised-** The state of coming out of being under the rule of a country or gaining independence from a colonial power.
- **GDP-** GDP stands for "Gross Domestic Product" and represents the total monetary value of all final goods and services produced (and sold on the market) within a country during a period of time (typically 1 year).
- **GNP-** Gross National Product (GNP) is the total value of all finished goods and services produced by a country's citizens in a given financial year, irrespective of their location. GNP also measures the output generated by a country's businesses located domestically or abroad.
- **FDI-** Foreign direct investment (FDI) is when a company takes controlling ownership in a business entity in another country. With FDI, foreign companies are directly involved with day-to-day operations in the other country. This means they aren't just bringing money with them, but also knowledge, skills and technology.

## 3.8. MODEL QUESTIONS

Short questions

- Name any three mechanisms brought in to rationalise the taxation process in India?
- What is the meaning of GDP?
- What can happen to the national economy if the financial administrators are not performing their duties properly?

**Medium questions**

- Which is the institution that coordinates the various departments' budgetary demands in Indian government?
- Administration in India is a matter between the politicians and bureaucrats explain the statement?
- Write a short note on the importance of financial stability for a nation?

Long questions

- Discuss the significance of financial administration in modern democracies?
- Explain in detail why the smooth and regulated functioning of the financial administrator in a country important for its economy?
- List any 3 ways in which public administration enhances the development of national economy?

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# UNIT 4 DISTINCTION BETWEEN PRIVATE AND PUBLIC FINANCIAL ADMINISTRATION

**STRUCTURE**

**4.1.Learning Objectives**
**4.2.Introduction**
**4.3.What is private financial administration (management)**
**4.4.What is public financial administration**
**4.5.Conclusion**
**4.6.Summary**
**4.7.Key words**
**4.8.Model questions**
**4.9.References**

## 4.1. LEARNING OBJECTIVES

After going through this unit, one should be able to:

- Explain the meaning and the concept of private financial administration.
- Describe the differences between public institutions and private institutions in handling respective finances.
- Discuss how public finance is oriented towards public policy.
- Discuss how private finance is oriented towards profit maximisation.
- Bring out the distinction between public and private financial administration both in terms of institutions and processes.

## 4.2. INTRODUCTION

Finance is an important function is any business as money is required to support its various activities. No organization in the modern world can survive without a regulated flow of finance. It is the money that flows into any organisation be it public or private that keeps the machine running. The consequences of such a smooth function in case of public institution is the proper implementation of public policies put forward by the state machinery to achieve general public good/welfare. For private institutions the same leads to profit making for the increase and expansion of the institution's economic power and keeping the workforce agile and active for better performance. Public finance implies broadly the money that is with the government. It is the branch of economics that assesses the government revenues and expenditure and its adjustment to achieve the desirable objectives. Thus, comprehending the essence of public finance depends upon an understanding of the nature of economics. This comprehension in modern democracies is done by means of public financial administrators looking after public money. The same is there in private institutions in the form of financial managers who take care of the operations of the institutions keeping the investors' money safe and yield profits.

Financial administration is very important to every type of organization. It refers to that part of managerial activity concerned with the procurement and utilization of funds for business purposes. Howard and Upton have defined the financial administration as it involves the application of general management principles to financial operations. The scope of financial administration is very wide and it should not be considered to be merely restricted for raising of capital. It also covers other aspects of financing such as assessing the needs of capital, raising sufficient amount of funds, cost of financing, budgeting, maintain liquidity, lending and borrowing policies, dividend policies and so on. Finance is considered as the life-blood of any business. It is defined as the provision of money at the time it is needed. In the early half of the 20th century, the job of financial administration was largely confined to the acquisition of funds for meeting the demands of the institutions. Private business firms continued to expand in this era. As the private domain of markets and the markets itself became larger. With increased diversity, greater control of financial operation took precedence and became important. In such a scenario, businesses would remain mere institutions of daily capital rotation rather than serve as developmental structures for their investors and their operators unless adequate money is available to convert them into reality. In essence private financial management is concerned with broadly four tasks. The first and foremost is estimation of the fixed and working capital requirements; secondly, formulation of capital structure; thirdly, procurement of fixed and working capital; and fourthly, management of earnings. With an effective means of implanting the above-mentioned requirements a stable private institution can be financed properly. Thus, a competent form of structure is always necessary to maintain the principles of the finance management so that mismanagement, misappropriation and other form of derailment can be avoided.

### 4.3. WHAT IS PRIVATE FINANCIAL ADMINISTRATION (MANAGEMENT)

As per Francis Fukuyama, the fall of USSR had led to the erosion of substitutive ideologies to market capitalism. Though the theorist has recently taken his assumption back and retracted, the evident truth of modern-day economics is that market politics are heavily sided with the capitalist section worldwide rather than the alternatives of few other nations. In such a scenario where, private business takes precedence in global economy over public financial progression it can be rightly assumed that financial management has grown by leaps and bounds in the present order. To put in simple terms financial management is a managerial activity concerned with planning and controlling of the firm’s financial resources to generate returns on its invested funds. The goals of such a firm/institution is primarily raising and using of capital for generating funds and paying returns to the suppliers of capital. This is the core finance function of a firm. Thus, the prerogative for financial managers in private sector remains that the funds raised by the company shall be invested in the best investment opportunities, with an expectation of future benefits. The process of financial management includes various processes that are crucial to an effective utilisation of funds for the company’s benefit planning. These processes include organizing, directing and controlling the financial activities such as procurement and utilization of funds of the enterprise. It also means applying general management principles to financial resources of the enterprise. The scope of financial management includes:

• Investment decisions: includes investment in fixed assets (called as capital budgeting). Investments in current assets are also a part of investment decisions called as working capital decisions.

• Financial decisions: relate to the raising of finance from various resources which will depend upon decision on type of source, period of financing, cost of financing and the returns thereby.

• Dividend decision: The finance manager has to take decision with regards to the net profit distribution. Net profits are generally divided into two:

a**) Dividend for shareholders-** dividend and the rate of it has to be decided.

b) **Retained profits-** amount of retained profits has to be finalized which will depend upon expansion and diversification plans of the enterprise.

The financial management of any institution has to take three important decisions to enhance its economic quality in terms of objective goals-

(i) Investment decision- decisions about where to invest fund and in what amount,

(ii) Financing decision- decision that answer the question regarding from where to raise funds and in what amount for investment into the company.

(iii) Dividend- the amount of money the institution needs to pay for functioning. In simpler terms how much to pay dividend and how much to retain for future expansion. In order to make these decisions the management must have a clear understanding of the objective sought to be achieved. It is generally agreed that the financial objective of the firm should be maximization of owner's economic welfare.

There are two widely discussed approaches or criterion of maximizing owners' welfare –

**(i) Profit maximization.**

**(ii) Wealth maximization.**

It should be noted here that objective is used in the sense of goal or goals or decision criterion for the three decisions involved.

**Profit Maximization**: Maximization of profits is the process of increasing the gains of a company over a particular period of time on investments, sale or production. Therefore, maximisation of profits is very often considered as the Financial Management's main objective of a business enterprise. The shareholders, the owners of the business invest their funds in the business with the hope of getting returns and the expectation is always targeted at gaining higher dividend on their investment. It is always the profitability of the business which is considered the prime indicator of the sound condition of the organization. The core reason behind this is the fact that it safeguards the economic interests of various social groups which are directly or indirectly connected with the company which includes but doesn't limit itself to the shareholders, creditors and employees. The ideals remains that these units get reasonable return for their contributions to the entity. The proper execution of this is possible only when the company earns higher profits for itself or accumulates sufficient profits to discharge the obligations that are to be honoured by them.

**Wealth Maximization**: The factor of wealth maximization is a universally accepted criterion for financial decision making across institutions. Wealth of an entity is to be calculated in simple terms by adding the assets and subtracting the debts of the entity. If after such a calculation there is an excess resource remaining with the entity that can be termed as wealth of the entity The value of an asset is generally to be viewed in terms of benefits it can produce over the cost of capital investment. Ira Solomon of Tulane University has defined the concept of wealth maximization as follows-

"The gross present worth of a course of action is equal to the capitalized value of the flow of future expected benefits, discounted (or as capitalized) at a rate which reflects their certainty or uncertainty. Wealth or net amount of capital investment required to achieve the benefits being discussed. Any financial action which creates wealth or which has a net present worth above zero is a desirable one and should be undertaken. Any financial action which does not meet this test should be rejected. If two or more desirable courses of action are mutually exclusive (i.e., if only one can be undertaken) then the decision should be to do that which creates most wealth or shows the greatest amount of net present worth".

In private institutions, financial management has the operational objective to maximize wealth or net present worth. Regarding the same, it can be said that the concept of wealth maximization is based on cash flows (inflows and outflows) generated by the decisions of the financial managers. If inflows are greater than outflows, the decision is productive because the resultant shows that maximization of the wealth of the owners has happened. Administration in the form of management is crucial to the functioning of a private organisation in global market system which is the most pervasive form of economic system available. Though no system is perfect and even after the most secure and stable form of functioning, a firm can be affected due to global forces going haywire such as the one happened in the Great Depression of the late 1920's and the global recession of 2008, but the success of financial managers has been to avert global economic collapse amongst various financial systems and maintaining a healthy financial relationship not only between countries but also between companies as well.

## 4.4. WHAT IS PUBLIC FINANCIAL ADMINISTARTION

Public finance is defined as the study of the financial activities of government and public authorities that work under the government. Though some form of financial administration is prevalent in every country to look after public finance, it is mostly in representative democracies that we see an unencumbered effective financial administration functioning for the good of the people and development of the nation. It describes and analyses the expenditures of government and the techniques used to finance these expenditures. It studies the activities discharged, and services provided by the government and the taxes being used to generate its funds. The public financial administrator examines the influence of government financial operations on growth, employment, prices etc. which are of paramount importance to the ruling as well as maintenance of peace and security in a state. The physical and social infrastructures are integral to the objectives of public finance and can only be looked after by a permanent authority that acts as a bridge between action-oriented procedures and allocation based on analysis of revenues- The Public Financial Administration. In case of India this institution is called the Finance ministry under the government of

India which coordinates the total national economy, finance and regulates it for national development. The State's role and activities are all linked to public finance which in turn seen by the administrators in the ministry. In India, State intervention through policies related to public finance, includes ensuring safety and security of the people, which are:

- Protection of property rights of the citizens
- Reduction of wide regional disparities
- Development of physical and social infrastructure
- Correction of markets
- Lessening the gap between income inequalities
- Provision of education, health care, sanitation and hygiene, support price to agriculture etc.

Public finance can be explained in the following subtypes-

1) Public Revenue

Public revenue collects money from the public through direct and indirect taxes penalties, fines, fees, maintenance, etc.

2) Public Expenditure

Public expenditure is the expenditure for the public like infrastructural facilities, basic health facilities, medical and educational facilities, etc.

3) Public Debt

When the expenditure exceeds the revenue, the government can take the help of debt to fulfil the country's needs and run the economy.

Public financial administration is unlimited in it powers to use the revenues earned y the government but the responsibility is also high the scope for individual economic nourishment is very limited in such a scenario. Profit maximisation paves way for public good based on proper implementation of public policies designed in close coordination with the departments that require budgetary allocation. Financial management of the national finances based in public funds, lead to facilitation of economic growth of the country, ensuring full employment of the populace, price stability of commodities in the domestic market and equitable distribution of wealth between the people. These are some of the important objectives of financial administration that make it stand out in stark contrast with private entities under private managers.

### 4.5. CONCLUSION

There is a clear distinction between how a public entity function regarding matters of finance and how a private entity function. Though there may be similarities between the goals and principles of the two, how one manages the finance it generates varies in degrees of both quality as well as quantity.

Public financial administration shows the following features-

1) The government agencies under the leadership of the Public financial administrator balance their income and expenditure.
2) A government based financial administration does not save any funds and has to spend whatever revenues have been accrued under a specified budget.
3) The public financial administrator has the power to raise loans internally and from another person or from externally as required under budgetary concerns.
4) There is flexibility in public finances, for example the government cannot resort to deficit financing. The financial administration will be rendered incapable of implementing public policies if such form of economic deficit is faced.
5) Public financial administrators can under directive of the government can take recourse to compulsive measures.
6) The government in case of any emergency has the authority to print notes. Through the national mind and the central bank of a country the government has the right to print notes
7) The scope of public finance is wide. Private finance has limited scope.
8) Public financial administration has to incur a compulsory characteristic as it has to incur certain expenditure which is necessary for example- defence or civil administration, both of

which cannot be left to private management as national security and matters of law and order are at stake here.

Private financial management on the other hands shows the following features-

1) Individual private entities adjust the expenditure. Financial managers tend to allow expenditure based on the income of the company and thus are limited in action.
2) Private companies tend to save money to hold financial resource and keep it aside for surplus budget. This surplus is to be used on advice of the financial manager but the advice isn’t bound on the private owners.
3) A private institution can only take loan from another private entity or from another external agency, the government is liable to help such entities in times of financial ruin incurred by mismanagement.
4) Funds of a private institution are managed by recruited individuals based on contracts rather than expertise based professional work force as mandated and maintained by public financial organisations.
5) A private entity legally has no to use or rather cannot use compulsive measures to get income or revenue. Financial managers can suggest methods of increasing the same but those cant be compulsion based.
6) No entity except the government has the legal right to print notes. Private Financial management is rendered incapacitated in such a situation.
7) Private finance has limited scope as the goals and objectives are limited by goals of profit and wealth maximization.
8) Private finance cannot be optional as some expenses can be postponed.

## 4.6. SUMMARY

- Finance is considered as the lifeblood or any business. Scope of financial management includes: Investment decisions, financing decisions and dividend decisions. The financial management is generally concerned with procurement, allocation and control of financial resources of a concern. Its main objective is to maximize the profits and value of shareholder funds. Main functions of financial management are: Estimation of capital requirements, determination of capital's composition, investment of funds, and financial control.
- Financial management takes majorly 2 forms to cover the holistic corpus of finance in the world. One is private financial management and the second is the public financial administration.
- Private financial management is centred around the goals of profit and wealth. It seeks to protect the investment made by investors in the institution, lessen the cost of production, procurement to save the capital of the firm and pay dividends based on mutually agreeable terms. This holistically enhances the economic condition of the firm, yielding returns for the people who have invested in its production or services as well as maintaining the personnel recruited by paying dividends.
- Public finance is a key component of government activity. It deals with government revenue, expenditure, public debt, borrowings, and related financial aspects. This unit provides an overview of the concept of public finance, types, and its linkages with public policy and makes distinction between public and private finance.
- Public financial administration is related to the use of public money by the government and its functionaries. In such a situation the government imposes tax on the populace as well as on products to earn a certain amount of money in the name of the national exchequer. It also earns money on sale of goods and services in the form of exports and earns dividends on taxable imports. The money earned is to be used for implementing public policies as devised by the various departments working under the financial administrator of the country.

## 4.7 KEY WORDS

- **Financial Management-** The planning, directing, monitoring, organizing, and controlling of the monetary resources of an organization.
- **Auditing-** An examination and verification of a company's financial and accounting records and supporting documents by a professional, such as a Certified Public Accountant.
- **Profit-** a financial gain, especially the difference between the amount earned and the amount spent in buying, operating, or producing something.
- **Investment-** it is an is an asset acquired or invested in to build wealth and save money from the hard-earned income or appreciation. Investment meaning is primarily to obtain an additional source of income or gain profit from the investment over a specific period of time.
- **Dividends-** Dividend refers to a reward, cash or otherwise, that a company gives to its shareholders. Dividends can be issued in various forms, such as cash payment, stocks or any other form. A company's dividend is decided by its board of directors and it requires the shareholders' approval.
- **Wealth-** Wealth measures the value of all the assets of worth owned by a person, community, company, or country. Wealth is determined by taking the total market value of all physical and intangible assets owned, then subtracting all debts. Essentially, wealth is the accumulation of scarce resources.
- **Finance-** Finance is defined as the management of money and includes activities such as investing, borrowing, lending, budgeting, saving, and forecasting. There are three main types of finance: (1) personal, (2) corporate, and (3) public/government.
- **Great depression-** The Great Depression was the greatest and longest economic recession in modern world history that ran between 1929 and 1941. Investing in the speculative market in the 1920s led to the stock market crash in 1929, which wiped out a great deal of nominal wealth.

## 4.8 MODEL QUESTIONS

**Short questions**

What is finance?

What is the orientation of private financial management?

Explain auditing?

**Medium questions**

- Explain in short how wealth of an entity be measured?
- What is meant by Great Depression and when did it took place?
- Discuss in various way that public money is used by the financial administrators?

**Long questions**

- Explain the two major objectives of private financial management?
- Discuss in detail how Ira Solomon explains wealth maximization?
- Explain any 4 differences between Private financial management and Public financial administration in detail?

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# UNIT 5 IMPACT OF NEOLIBERALISM ON FINANCIAL ADMINISTRATION

## STRUCTURE

5.1.Learning Objectives
5.2.Introduction
5.3.What is neoliberalism
5.4.Indian experience with neoliberalism
5.5.How neoliberalism changed Indian financial administration
5.6.Conclusion
5.7.Summary
5.8.Key words
5.9.Model questions
5.10. References

## 5.1. LEARNING OBJECTIVES

After going through this unit, one must be able to-

- Understand what is meant by neoliberalism
- Explain how neoliberalism as a phenomenon changed global markets
- Understand what led India to accept neoliberal market policies
- Discuss how neoliberal policies changed Indian economy
- Analyse the impact of neoliberalism on Indian financial administration

## 5.2. INTRODUCTION

Modern markets have gone through immense changes over the years. Since the times of industrial revolution to the modern age of crypto currency markets have transformed not only economies but nation states as well. The free market describes an economic system where people voluntarily trade with one another in their own self-interest. A purely free market can only be conceptualised with little to no government intervention or regulation, where there is no restrictions and individuals as well as companies are free to trade as they please. The market economy has existed in various forms ever since human beings began trading with one another which can be traced back to barter system prevalent during silk route to the era when gold and silver were prime modes of currencies and to the modern system of paper currency and digital currency. To trace the origins of free markets one can, see their emergence as a natural process of social coordination between groups of people with the intention to exchange good and services against some form of payment. Thus, it was no single intellectual who can be credited for inventing a process of voluntary exchange or private property rights. Rather it likely emerged as the natural outcome of human behaviour. Traditionally various factors have contributed to the dominance of market economies all over the globe. It has made its presence felt in all important spheres of public life as it renders the prime resource for all major functioning- money in the form of finance.  Administration has not remained untouched by it about which we will learn in the coming parts of the unit.

Majorly, there are two pillars of the market economy: voluntary exchange and private property. It is not possible for trade to occur without one or the other, at least in a market economy. If such an economy is functioning without each of the aforementioned two features it rather becomes a centralised economy. Thus, market economy is only compatible with the ideology of capitalism that allows unrestricted freedom of exchange without interventions or interruptions as capitalism is an organizational system of how goods are created—where business owners and investors (capitalists) assemble productive resources in a centralized entity, such as a company or corporation. These business owners own all of the tools, machinery, and other resources used in production, and keep the majority of the profits. In turn, they hire employees as labour in return for salaries or wages. Labour does not own any of the tools, raw materials, finished products, or profits—they only work for a wage.

The free-market functioning as itself describes how the laws of supply and demand will be affected by the decisions of economic actors. A free market may describe the behaviour of consumers in industrial capitalism, but it can also refer to the interactions between traders in pre-agricultural societies. The study of market economics is frequently traced to Adam Smith, who described the relations between producers and consumers in The Wealth of Nations. David Ricardo later formalized a mathematical model of this relationship in The Principles of Political Economy and Taxation.

## 5.3. WHAT IS NEOLIBERALISM

The term ‘neoliberalism’ passed into popular usage among left-wing commentators in the late 1970s as an essentially pejorative term. It was used widely as a theory that supported free market policies that were developed and implemented in the period when the first woman prime minister of Great Britain, Mrs Margaret Thatcher and the actor turned politician Ronald Reagan became US president in 1979 and 1980 respectively. Essentially, it became known as a set of related public policies that was aimed at deregulating capital markets, embracing ‘free trade’ globalization, and privatization policies responsible for state assets sale. In essence it meant commercialization and corporatization of government departments with the overall aim of paring back the state and increasing individual responsibility. These were the public policies aimed to increase funding for the private sphere and limited government interference was considered the agenda mostly put forward by conservative and right-wing governments whose intent was directly on limiting the powers of the state, attacking ‘big government’ and repealing social welfare provisions. The ‘Washington Consensus’ was a term developed by John Williamson in 1989 to describe the policies of Washington, DC based institutions such as the World Bank, the International Monetary Fund, and the US Treasury in ten points, including: fiscal policy discipline; redirection of public spending away from subsidies to user-pays; tax reform; market interest rates; competitive exchange rates; trade liberalization; privatization of state assets; deregulation; and securing property rights.

If we are to see the journey of liberalism in a theoretical sense, there can be simply 3 stages that are considered to be majoritarian trends.

a. Neoliberalism in this sense can be seen as the upgraded version of the first kind i.e., Classical Liberalism, which didn’t go as far as the its theorists or proponents would have wanted.
b. Second being Welfarism (Welfare State) which supported government intervention to the point of protecting and safeguarding the people based on high libertarianism.
c. Neoliberalism being the last one which is an overarching theory of today. The Neo-liberal’s conception of the minimalist State approximates Classical Liberalism’s emphasis on the State

> being a mere protectionist (law and order) outfit leaving the individuals free to pursue their self-interest in a manner deemed the best possible by them.

Neoliberalism holds up the idea that a society's political and economic institutions should be robustly liberal and the system must support all ventures that are capitalist in nature. It will nonetheless be supplemented by a constitutionally limited democracy based on people's vote and a modest welfare state. Neoliberals endorse liberal rights and the free-market economy to protect freedom of the population and promote economic prosperity. This helps the people both in ideal terms as well as materialistic terms. Neoliberals are broadly democratic in nature supporting liberal values, but stress the limitations of democracy as much as its necessity. And while neoliberals typically think government should provide social insurance and public goods, they are sceptical of the regulatory state, extensive government spending, and government-led compulsive policy-making.

## 5.4. INDIA EXPERIENCE WITH NEOLIBERALISM

India's long-time ally, the USSR had collapsed due to the internal inadequacies of its system in the early 1990s. 1991 was the year when all help stopped from the ally and with the problem in the middle east the country was facing an acute economic crisis, which was triggered by an increase in world crude oil prices following Saddam Hussein's onslaught of Kuwait in August 1990. Price of crude oil increased and inflation skyrocketed in many countries. The balance of payments (BoP) situation became unmanageable. The loans that were due for India became a big problem to pay back. The economy was in dire straits. There was a sharp reduction in the foreign exchange reserve due to a sharp decline in capital inflows and the liabilities increased. It was a serious threat to the sustainability of the growth process. India was close to defaulting it dues internationally. The situation can be compared to what Sri Lanka faced recently.

To put matters into perspective and to understand the gravity of the situation there is the given conversation between then chief economic adviser to the government Deepak Nayyar and the Managing Director of IMF regarding extension of deadline and the requirement of additional funds to stabilise the economy. the situation was so inflamed that Mr. Nayyar, who went to the IMF for financial support, told Michel Camdessus, the MD of IMF that- ‘If the Fund (IMF) cannot extend a lifeline, we will bring the shutters down’ which inadvertently meant that India would come out of all global financial obligations and would be forced to work with a 100% state-controlled economy.

Consequently, there was a minority government at the Centre under the leadership of Chandra Shekhar but the government wasn’t stable and comprised of various parties anti-thetical to the idea of working together. Although the government was making all efforts to come out of the crisis, it could not deal with the economic challenges. There was a need for a strong government at the Centre to deal with and address the economic problems. After the fall of the Chandra Shekhar government, general elections were called. Therefore, the general election of the 10th Lok Sabha was announced and the Congress party emerged as the single largest. The party formed the government under the leadership of PV Narasimha Rao, who appointed the Oxford based economist Dr. Manmohan Singh as Finance Minister in the government.

To counter the liquidity problem, the government ushered in policy reforms aimed at speeding up the pace of economic growth. The reforms began with the devaluation of the rupee on July 1, 1991, followed by a second round of transfer of a total of 46.91 tonnes of gold from the reserve assets of the RBI in Mumbai to the Bank of England, which enabled India to borrow $400 million to solve its liquidity problems. Earlier, in the first round, the Chandra Shekhar government had transferred 20 tonnes of gold to the Union Bank of Switzerland in the form of a sale with repurchase option. At that time, the gold was not from the reserves held by the RBI but those confiscated from smugglers and kept with the State Bank of India. The government managed to garner about $200 million to address the BoP problem. July 24 was, by far, the most dramatical day, when the government took two crucial steps.

A. First, the government announced a new industrial policy to liberalise the economy, increase employment opportunities, boost production and productivity, make Central public sector units more competitive, and encourage foreign investments. The policy had deregulated the industrial sector substantially.

B. Second, the Union Budget presented by Manmohan Singh in the evening changed the destiny of the country. It sought to extend the reform measures taken by the government in the previous months. The aim of the Budget was to address the balance of payments problem and change the structure of Indian economy from state controlled to state coordinated. Thus, structural changes were introduced and in an unprecedented manner for the first time.

The economic reform initiated in 1991, followed by further measures undertaken by successive governments, have helped our country emerge as one of the fastest growing economies in the world. The foundation for a new era of development was laid by the Rao-Singh duo, which was built upon by all successive governments.

### 5.5. HOW NEOLIBERALISM CHANGED INDIAN FINANCIAL ADMINISTRATION

Since 1991 many reforms have been introduced by successive governments to make the Indian economy capable enough o sustain itself in the global markets. The 1990s; has a string of coalition governments thus leading to some form of vulnerability but the system maintained by the strong bureaucracy and close coordination of various organisation was able to save itself. It was only with the 1999 NDA -1 (National Democratic Alliance) government led by Atal Bihari Vajpayee that the era of stable coalition governments began in India. With finance ministers such as Yashwant Sinha in its ranks the financial administration was made to become more responsive to the needs of the global market. The next UPA -1 and 2 (United Progressive Alliance) under the former finance minister and then Prime minister Manmohan Singh that the trend continued. The finance ministry introduced various reforms to help the private sector as well as reduce state control-based dependency of the market. Major decentralisation was introduced in various spheres of governmental funding. This included introducing the PPP (private public partnership) model where private companies are encouraged of invest in governmental projects. This reduces the burden on the financial administration and brings private funding into the system. Monetisation of certain public sector companies was Introduced by the UPA 1 and 2 governments in areas of telecom, railways, fertilisers, crude oil and natural gas. Autonomy was provided to state financial administrators as well to encourage the states to being in funding by themselves without being dependent on the central governments for funds. States like Karnataka, Telangana, Tamil Nadu, Gujarat took major strides in walking along the trajectory set by the central government on self-funding. The setting up of SEZ (special economic zones) in various states to lure in industrialists for initiating investment was also a resultant of the Indian financial administration. The NDA2 government under Narendra Modi has only accelerated the process of accepting neoliberal methods which have been evident in his policies such as dismantling the Planning Commission in favour of the NITI Aayog, a think tank that brings in the chief ministers of various states and their finance ministers with the Union fiancé minister and Prime minister to plan about finances of the federative units (states) as well as the Union government. Other policies include monetizing various state resources, institution, decentralisation of powers to the states, deregulation of price of commodities, encouraging private players to take part in government projects, limiting welfare mechanism to help the most needed.

All the abovementioned reforms initiated by the financial administrators have opened up Indian economy to an extent unseen before 1990s. but the challenged brought in by removing restrictions has made the system more concerned. The rule of global market economy is that as investment increases so does the probability to defraud such investments for higher gains which are nonetheless illegal. Strict powers have been provided to financial watchdogs as policies have been eased by the government. The increase in powers of institutions such as the Enforcement Directorate, Serious Fraud Investigating Office (SFIO) and SEBI have given the financial administrators newer means to investigate and prosecute perpetrators of financial offences.

Cumulatively it can be said that the Indian financial administration has provided a balanced response to the needs of a neoliberal world. Markets have been provided more freedom; capitalists have been provided larger incentives to be part of the economy as well as increase their investment in both private as well as public ventures. At the same time stronger laws have been enacted and watchdogs given more powers to rein in factors that can bring harm to both public money as well as private money. The CAG has been the ever-vigilant accountability instrument that looks after the affairs of the state. Thus, it can be said that Indian financial administration has helped Indian economy find its feet on solid ground in the neoliberal atmosphere and have only enhanced participation of the various units in bringing major changes for the betterment of the system. To neoliberalism as a trend the response has been very balanced and enhancing for the administrators as well as the participants of the economy.

### 5.6. CONCLUSION

Indian economy as gone through major changes in its 70+ years of experience. From the Nehruvian policy of focus on centralised economy to Indira Gandhi’s focus on welfarism and slow liberalisation to the ushering of Indian neoliberalism in the early 1990s. liberalisation of policies, privatisation of companies, institutions and globalisation of the economy has brought changes not only to the financial sector of government and private players but have brought in changes in law, policies and above all to the financial administrators. Laws have been revamped to help neoliberal polices of market freedom, private investments, public private cooperative ventures etc. the government has introduced special economic zones and foreign direct investment of make the system responsive to global standards. This approach though has been full of caution and thoughtful irrespective of governments. India is a country of great diversity and the aspirations are as many as the people that reside here. Financial aspirations have been the cornerstone of these aspirations as its only with economic growth that a country can establish itself in the global order and therefore it becomes of utmost importance that the country’s financial system in in sync with the global trend. In that case the majoritarian system prevalent in the world is the neoliberal system, and its of much importance that India takes the stride in the right direction.

Indian financial administrators have ushered new beginnings for its financial structure and have answered its call to inject proper change when the situation demands it. It has been the same with neoliberalism that finance ministers, bureaucrats have brought in requisite changes to start the liberalisation, privatisation and globalisation of the Indian economy. The recent deregulation of commodity prices, decentralisation of powers, demonetisation, digitization are just the most modern steps in the process that began in the 1990s.

## 5.7. SUMMARY

- Neoliberalism is the newest version of the liberal theory that has been majorly accepted by the world economy along with its components of market economy and capitalism. The feature of neoliberalism includes market freedom, decentralisation of powers by governments and more impetus on private investments to target more profit.
- Indian liberalisation began in the early 1990s's with the Narsimha Rao govt bringing in major policies to usher in liberalisation, privatisation and globalisation of Indian economy as pressures of controlled economy as well as external help were strained during this era.
- Indian financial administrators from the start have been very flexible in their approach to global changes. The advent of neoliberalism was incorporated soon with new laws to decentralise the role of government in controlling the economy. There was major shift to coordinating rather controlling of economic ventures.
- Indian institutions have been cautious while ushering a new age for Indian neo liberalisation. SEBI. SFIO, CAG have been ever vigilant in their approach to safeguard the system from malfunctions as well as intentional harm. The strength of Indian financial administration is thus rooted in its ability to bring in changes when required while keeping gatekeeping structures intact for the proper functioning as well as safeguarding of finances of both public and private in nature.

## 5.8. KEY WORDS

- **Neoliberalism-** Neoliberalism is contemporarily used to refer to market-oriented reform policies such as "eliminating price controls, deregulating capital markets, lowering trade barriers" and reducing, especially through privatization and austerity, state influence in the economy.
- **Wage-** a fixed regular payment earned for work or services, typically paid on a daily or weekly basis.
- **Barter system-** Barter is an act of trading goods or services between two or more parties without the use of money —or a monetary medium, such as a credit card. In essence,

bartering involves the provision of one good or service by one party in return for another good or service from another party.

- **Pejorative**- anything that expresses or is expressing contempt or disapproval.
- **Liberalisation**- Liberalisation is the process or means of the elimination of control of the state over economic activities. It provides a greater autonomy to the business enterprises in decision-making and eliminates government interference.
- **Privatisation**- Privatization occurs when a government-owned business, operation, or property becomes owned by a private, non-government party. Privatization may also describe a transition that takes a company from being publicly traded to becoming privately held.
- **Globalisation**- Globalization is the word used to describe the growing interdependence of the world's economies, cultures, and populations, brought about by cross-border trade in goods and services, technology, and flows of investment, people, and information.

## 5.9. MODEL QUESTIONS

### Short questions

- Name two leaders and their policies that brought forward neoliberalism into the mainstream?
- Explain any 4 features of neoliberalism?
- What crisis led to the Narsimha Rao government to initiate economic reforms in India?

### Medium questions

- Explain the institution of NITI AAYOG?
- What is Washington Consensus?
- Explain the transition of Indian economy from state controlled to liberal economy?

### Long questions

- Explain the term Neoliberalism in detail?
- Evaluate the impact of neoliberal policies on India financial administration?
- Critically examine the phenomenon of neoliberal market policies?

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BLOCK II

Unit 1

Concept of Fiscal Policy- equality and social justice

STRUCTURE

1.1 Objectives
1.2 Introduction
1.3 What is Fiscal Policy? Relation of Fiscal Policy with equality and social justice
1.4 Role of Fiscal Policy in India
1.5 Fiscal Policy in India- a historical understanding, important breakthroughs and challenges
1.6 How far Indian fiscal policy could attend to equality and social justice in India?
1.7 Conclusion- how the discussion fulfilled its objectives
1.8 Summary
1.9 Keywords
1.10 Model questions
1.11 References

1. 1.1 Objectives-

- To understand the concept of fiscal policy and its connection with social justice and equity
- To understand the role of fiscal policy in India
- To learn how India had designed its fiscal policy framework and how it has averted financial crises
- To understand how social justice and equity have been enabled by fiscal policy in India

## 1.2 Introduction

This unit deals with the concept of fiscal policy. It specifies how fiscal policy in India is designed and how it manages the economy of the nation. The exhaustive discussion that follows is divided into sections. The first section elaborates on the meaning of fiscal policy and understands how it is connected with enabling social justice and equity in India. The second section presents an overview of the role of fiscal policy in India. The third section goes on to give a brief idea about the evolution and functioning of fiscal policy in India and discusses how fiscal policy has been redesigned to cope up with external and global financial crises. The last section attempts to understand how social justice and equity have been preserved or can be attained by fiscal policy in India.

## 1.3 What is Fiscal Policy? Relation with Equality and Social Justice

Fiscal Policy refers to Government's management of the nation's economy by determining how financial resources are to be raised and spent in the nation. It is based on the ideas of J M Keynes, the British economist which state that the governments influence the macroeconomic productivity in the nations by deciding on the increase and decrease of raising and spending of public finances. This relates to the fact that the involvement of the government is a necessary factor in entailing a vibrant economy. Following from this, the sole aim of fiscal policy is to ensure economic growth and development in any nation. Such economic growth and development must be comprehensive as to ensure poverty reduction, employment generation, social inclusion and equity in the nation. As such, Fiscal policy has to be so developed that it could ensure equality and social justice in the nation.

The economy of the nation has to be so monitored that it can ensure social justice and equality in the society which means that all should benefit from economic growth and development. Fiscal policy has a major contribution towards this. Musgrave (1959) points out three aims of fiscal policy to the end of social justice and equality-

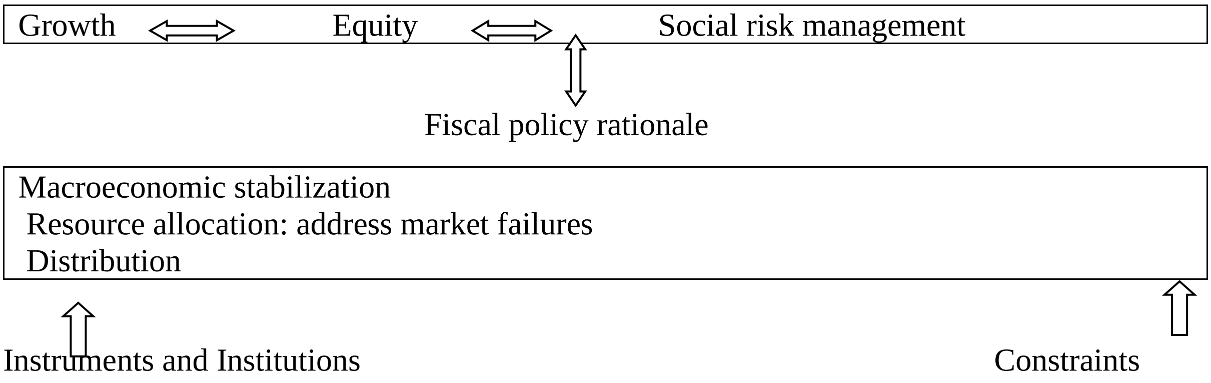
- Fiscal policy should ensure macroeconomic stabilization
- Fiscal policy should improve resource allocation and
- Fiscal policy should mitigate distributional disparities

To ensure macroeconomic stabilization, Fiscal policy should be so designed that it can avert the pressures of unemployment and inflation. Fiscal policy also has the capacity to keep fiscal deficits and public debt stable and sustainable.

The fiscal policy contains potential to adjust the expenditure and tax policies of the government in such a way that it can deal with critical market failures and ensure long term development.

Fiscal policy should be so designed that it can adjust distribution of income, opportunities, assets and market risks so that general social welfare is sustained.

Brahmabhatt and Canuto (2012) in their work designed a framework outlining the development and growth objectives of fiscal policy for developing nations which will be presented here-


Growth
Equity
Social risk management
Fiscal policy rationale
Macroeconomic stabilization
Resource allocation: address market failures
Distribution
Instruments and Institutions
Constraints

Instruments and Institutions

Political economy and institutional capacity constraints

Fiscal sustainability

Efficiency costs of taxation and borrowing

Constraints

Public spending levels, composition and efficiency

Tax policies and revenue mobilization

Financing and public balance Sheet

Public financial management and governance of institutions

Source: Brahmbhatt and Canuto (2012)

### 1.4 Role of Fiscal Policy in India-

- Development

The primary objective of fiscal policy in India is to ensure economic growth and development which is attained by mobilization of resources.

- Efficient allocation of Financial Resources

The designing of fiscal policy and its implementation should be such that it could ensure efficient and economical allocation of financial resources for various developmental functions in the nation on the part of the Central and state governments. Developmental functions refer to expenditure on transport, infrastructure, housing and the likes. Finances are also required to be allotted for non developmental functions like defense, subsidies, interest payments and many more such activities.

- Reduction in inequalities of Income and Wealth

Fiscal policy in India thrives towards ensuring social justice and equity in the nation. This means distribution of income in such a way that the gap between the higher income groups and poorer sections can be bridged. The taxation regime is designed in such a way in the country that this objective can be fulfilled.

- Price Stability and Control of Inflation

Fiscal policy has to be so designed that inflation can be controlled. This is to be achieved by the means of reducing fiscal deficits among other things.

- Employment Generation

Fiscal policy in India also ensures employment generation. Investment in infrastructure creates employment. Again "Lower taxes and duties on small-scale industrial (SSI) units encourage additional investment and consequently generates additional employment" (R and Balan P 2018: 507)

- Balanced Regional Development

Balancing regional development can also be enabled by fiscal policy. Expenditures on developmental projects on backward regions are a major step towards this

- Reducing the Deficit in the Balance of Payment

> "Fiscal policy tries to encourage additional exports by manner of financial measures like Exemption of taxation on export earnings, Exemption of central excise duties and customs,Exemption of nuisance tax and tariff, etc" (ibid)

- Capital Formation

Economic growth can be enhanced by accelerating capital formation. If fiscal policy is efficiently designed it can encourage savings and discourage disembursements and as a result capital formation can be ensured.

- Increasing National Income

As fiscal policy aims at enhancing economic growth of the nation, this will increase the gross domestic product of the nation, per capita financial gain and the value of the country.

- Foreign Exchange Earnings

Fiscal policy is designed as such that it could ensure effective foreign exchange earnings- "These policy tries to add extra exports by manner of financial Measures like, exemption of taxation on export earnings, exemption of excise tax and octopi, etc. exchange provides business enterprise advantages to import substitute industries. The exchange achieved by means of exports and saved by way of import substitutes helps to solve the balance of payments problem" (R and Balan P 2018: 508).

### 1.5 Fiscal Policy in India- a historical understanding, important breakthroughs and challenges

Fiscal policy refers to the overall economic strategy of the country for development a growth in the nation. The overall economic framework of the government includes how to collect revenues in the country so that expenditure and investments can be made. This therefore covers taxation policy, expenditure policy, and measures to manage debt, deficits or surplus. Fiscal policy in India has evolved according to the various circumstances which the nation has faced over time. This section deals with how the fiscal policy in India has been shaped and evolved over time so that it could response to internal and global financial crises.

India has a federal structure of governance with a three tier system where powers and functions are divided between the Centre, states and local levels like municipalities and Panchayats. The Constitution of India has elaborated on the fiscal policy framework of the nation whereby the taxation powers and spending responsibilities of each of the three tiers of governments have been specified. In addition to this the Constitution has provided for the formation of a Finance Commission at the national and state levels every five years in order to give guidance to the centre and the states with regard to fiscal matters. Along with these the Constitution also provides for the preparation of an annual financial statement by the centre and the state governments which have to be presented to the legislature. This financial statement is termed as the annual budget which elaborates on the estimated income and expenditure of the governments for the upcoming year. Therefore, the Constitution of India has provided the architecture for the fiscal policy in the nation. However going beyond fiscal provisions, in India there has been the formation of a planning commission every five years to plan for long term economic development objectives for a period of five years. The implication of this planning process for fiscal policy was in the planning process- "the planning process is the division of expenditures into plan and non-plan components. The plan components relate to items dealing with long-term socio-economic goals as determined by the ongoing plan process. They often relate to specific schemes and projects. Furthermore, they are usually routed through central ministries to state governments for achieving certain desired objectives. These funds are generally in addition to the assignment of central taxes as determined by the Finance Commissions" (De 2012: 7). The planning process in the nation for development and growth by virtue of a planning commission in India was replaced with the formation of the Niti Aayog in 2015 when Narendra Modi took over the Prime Minister ship in India. Niti Aayog was formed by a resolution of the Union Cabinet emerging as a policy think tank of the government which was to provide directional and policy inputs to the government- “This was done in order to better serve the needs and aspirations of the people of India” (https://www.niti.gov.in/niti/content/overview).

India followed a planned economy since 1950. This meant that economic development was mostly planned in the country and there was increased emphasis on the development of public sector enterprises for attaining economic growth and industrial development. Evidently there was imposition of strict administrative controls on private industries and there prevailed a system of licensing and quotas for private enterprises. Along with this, there was restriction on external trade and imports. The fiscal policy framework therefore functioned under the background of a planned economy. The main role of fiscal policy under this system “was to transfer private savings to cater to the growing consumption and investment needs of the public sector. Other goals included the reduction of income and wealth inequalities through taxes and transfers, encouraging balanced regional development, fostering small scale industries and sometimes influencing the trends in economic activities towards desired goals” (Rao and Rao cited in De 2012: 8). Under this framework, the taxation regime was aimed towards extracting revenues from private sectors in order to fund public sector and also to achieve distributive justice and bridging inequalities. The Central and state tax revenues did increase at this point under this framework. However this system was designated to be inefficient and inequitable because the tax base was too narrow with an inadequate reporting of taxation bases and incomes. Although tax reforms were initiated the problem of tax evasions was present.

Under this framework, expenditures were less which led to revenue surpluses both at the centre and in states. Revenue surpluses refer to a condition where revenues are more that the estimated expenditure of the government. This situation was altered by limited reforms whereby liberalization in trade, promotion of exports and investment in modern technologies were encouraged. This led to increased expenditures also sustained by borrowings from domestic and foreign sources.

Conditions arose where India’s external debt and expenditure patterns became unsustainable. This situation was accompanied by a balance of payment crises caused by external and domestic events- “The First Gulf War caused a spike in oil prices leading to a sharp increase in the government’s fuel subsidy burden. Furthermore, the assassination of former Prime Minister Rajiv Gandhi increased political uncertainties leading to the withdrawal of some foreign funds” (De 2012: 14). Such conditions propelled the government to change the economic strategy in the nation having major implications for reforms in subsequent fiscal policy framework.

Such crises saw the commencement of economic liberalization in India. This major shift from a planned economy to an open economy enhanced privatization, foreign investment and scrapping down of the hitherto prevailing restrictions on private sectors in forms of licenses and quotas. The fiscal policy framework also underwent reforms to conform to such changes. There were changes in the taxation regime and in the expenditure pattern. The tax reforms were such that rates of all major taxes were reduced, attempt was taken to minimize tax exemptions and deductions, laws and procedures of taxation were modified, attempt was taken to improve administration of tax and there was the introduction of increased computerization and modernization of the information system. However the tax system had preferential treatments and tax deductions as tax incentives for achieving socio-economic goals like setting up industries in backward areas, promotion of exports and development of technology. Such incentives led to the concept of zero-tax companies where tax liabilities of companies were minimized. To counter this phenomenon, the concept of Minimum Tax Alternative (MTA) was introduced which required companies to pay 30% of its profits as tax. Along with this, other attempts were taken to expand tax base increase revenues of government. In spite of major reforms in taxation regimes, the reforms of state governments were inadequate and sporadic. As a result of this realization, the indirect tax regime was simplified.

There was a change in the expenditure policy of the government which meant a reduction in subsidies provided by government and reduction of non-capital expenditures. Reforms in fiscal policy framework which led to increase in revenue of the government due to changes in tax administration and expenditure control of the government. This led to a control on government's fiscal deficits and more prudent handling of external debts. In order to bring about a more effective fiscal discipline, FRMBA was introduced in 2003. This Act- "gave a medium term target for balancing current revenues and expenditures and set overall limits to the fiscal deficit" and "enhanced budgetary transparency by requiring the government to place before the Parliament on an annual basis reports related to its economic assessments, taxation and expenditure strategy" (De 2012: 19).

The global financial crisis that took place in 2008 affected the Indian economy in three ways- "contagion risks to the financial sector; the negative impact on exports; and the effect on exchange rates" (Kumar and Soumya cited in De 2012; 20). However India could face the challenges posed by the global financial crisis quite effectively as a result of its prudent fiscal policy framework in operation. A prudent fiscal policy framework was accompanied by a well organized and regulated financial sector and capital account policy, large foreign exchange reserves and sufficient domestic consumption. Owing to the crisis, India took upon the task to keep its fiscal policy efficient. As a part of this, expenditure policies of the government was managed whereby now the focus was more on outcome than on allocations. It has been observed that "fiscal prudence and the desire to limit the public debt through better revenue and expenditure outcomes has been fairly institutionalised in the Indian policy matrix" (De 2012: 24)

Brahmbhatt and Canuto in a comprehensive study regarding how developing countries coped up with the challenges that the global financial crisis of 2008 has posed to their economies addressed the issue that fiscal policy in such countries should be operationalized in such a manner that distributive effects of such policy should be just and effective. They claim- "There are additional tools that may help policy makers better prepare to address the distributional impacts of the next crisis. The first is a simple qualitative questionnaire on fiscal decisions implemented at the sectoral level in a given period. The second tool is an approach to conducting ex ante microsimulations that focus on *opportunities* rather than on outcomes in the hope that the traditional short-term analysis of welfare outputs may be complemented with a discussion of the longer-term effects on equality of opportunity" (2012: 6)

### 1.6 How far Indian fiscal policy could attend to equality and social justice in India?

If fiscal policy has to be so designed that social justice and equity can be ensured, Indian fiscal policy has been able to move towards this aim. Fiscal policy in India could ensure distributive justice whereby it has been instrumental in uplifting the weaker sections of the society as various 0qeexpenditures have been initiated by the government attending to issues of distributive justice like health, education, food and gender. However the allocation of scarce resources is a dilemma that the fiscal policy framework must attend to. To ensure redistribution the financial burden certainly increases as more programmes may require more expenditure and this may lead to a fiscal deficit.  S S Tarapore acknowledges that- "What is unfortunate is that the fiscal deficit is attributed to subsidies for the weaker sections, and various programmes for alleviating poverty are erroneously deemed to be inefficient. When the fisc spins out of control and fiscal consolidation becomes necessary, invariably it is the weakest segments which bear the burden of adjustment while the stronger segments are well equipped to defend their turf Thus, it is not sufficient to focus on the aggregate of fiscal consolidation but how it is achieved" (Tarapore 2019).

The present government has been credited for undertaking initiatives for the upliftment of the weaker segments of the population. The fiscal policy framework in India has been structured and restricted for ensuring redistributive justice in the nation although it led to many other problems- Until 1980s, high rates of income taxes were imposed on the higher income groups in the country in order to ensure redistribution of income. However such punitive measures led to the prevention of productive activity and high level of tax evasions. From 1980s therefore the direct tax regime has been excessively diluted which resulted in the income tax rates to fall too low. Besides income tax, other taxes which have been diluted are wealth tax, gift tax and capital gains tax with excise duty being abolished.

The population however bears the burden of an aggressive indirect tax regime. Tarapore claims- "While not going back to the earlier confiscatory direct tax regime, there is merit in a golden mean under which the direct tax regime can be increased gradually while the harshness of the indirect tax regime is eased. This would be a salutary measure towards reducing the iniquity of the present tax regime" (Tarapore 2019). Also the Chief Justice of India, S.S Bobde observed that if the tax regime has to ensure social justice it should be against both excessive taxation and zero taxation. He claimed- ""arbitrary and excessive tax results in social injustice by the government…While tax evasion is a social injustice to fellow citizens, arbitrary and excessive tax also results in social injustice by the government" (https://economictimes.indiatimes.com/news/economy/policy/arbitrary-or-excessive-tax-results-in-social-injustice-by-a-government-cji-bobde/articleshow/73587557.cms)

## 1.7 Conclusion

The above exhaustive discussion could fulfill the objectives of this unit. It analysed that fiscal policy is designed in India in such a manner that the objectives of social justice and equity can be achieved. Its taxation policies and expenditure policies are redesigned so that redistribution of income can be facilitated and the economically weaker sections of the society can be uplifted. Fiscal policy has the role of promoting development in the nation by enabling infrastructural growth, generating employment and by upholding distributional justice. Fiscal policy is designed so that balance of payment crisis can be averted. Fiscal policy in India id designed under the auspices of the Constitution of the country. It has evolved as the Indian economy moved from a planned one to a liberalized one. Taxation policy, expenditure policy, investment policy have been formulated in India so that the challenges that global financial crises put on Indian economy could be faced. Again these policies depend on how social justice can be ensured in the nation. Whether taxation and expenditure should be more or less depend on the aim of enabling social justice and equity in India.

## 1.8 Summary

- Fiscal Policy refers to Government's management of the nation's economy by determining how financial resources are to be raised and spent in the nation.
- The sole aim of fiscal policy is to ensure economic growth and development in any nation. Such economic growth and development must be comprehensive as to ensure poverty reduction, employment generation, social inclusion and equity in the nation.
- Musgrave (1959) points out three aims of fiscal policy to the end of social justice and equality- Fiscal policy should ensure macroeconomic stabilization, should improve resource allocation and should mitigate distributional disparities
- The role of fiscal policy in India is to ensure development, social justice, and employment, mitigate balance of payment crisis, ensure equality, and reduce regional disparity among other things.
- The Constitution of India has elaborated on the fiscal policy framework of the nation
- The fiscal policy framework therefore functioned under the background of a planned economy until 1980s. Under this framework, the taxation regime was aimed towards extracting revenues from private sectors in order to fund public sector and also to achieve distributive justice and bridging inequalities.
- After liberalization, the tax reforms were such that rates of all major taxes were reduced, attempt was taken to minimize tax exemptions and deductions, laws and procedures of taxation were modified, attempt was taken to improve administration of tax and there was the introduction of increased computerization and modernization of the information system.
- India could face the challenges posed by the global financial crisis of 2008 quite effectively as a result of its prudent fiscal policy framework in operation. A prudent fiscal policy framework was accompanied by a well organized and regulated financial sector and capital account policy, large foreign exchange reserves and sufficient domestic consumption.
- Fiscal policy in India could ensure distributive justice whereby it has been instrumental in uplifting the weaker sections of the society as various expenditures have been initiated by the government attending to issues of distributive justice like health, education, food and gender.

## 1.9 Keywords-

Fiscal Policy, social justice, equality, taxation, expenditure, fiscal deficit, resource mobilization

## 1.10 Model questions

1. Explain the concept of fiscal policy (6 marks)
2. How is the concept of fiscal policy related to the idea of social justice and equality?(12 marks)
3. What is the role of fiscal policy in India? (18 marks)
4. Analyse how fiscal policy has been redesigned since 1950s to adapt to financial crises. (12 marks0
5. Point out the difference between the fiscal policy framework during a planned economy and during liberalization. (18 marks)
6. Could Fiscal policy ensure social justice in India? (12 marks)

## 1.10 References and further readings

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Unit 2

# Budgeting

## STRUCTURE

2.1 Objectives
2.2 Introduction
2.3 What is a budget?- principles and objectives of budgeting in India- analysis of past budgets – their principles
2.4 Types of Budget in India
2.5 Budgetary procedure in India
2.6 Analysis- transparency and participation in Indian Budgeting
2.7 Conclusion
2.8 Summary
2.9 Keywords
2.10 Model questions
2.11 References

## 2.1 Objectives-

The objectives of this discussion is-

- To make the readers acquainted with the principles and objectives that have guided budgeting in India
- To understand the process of budgeting in the country
- To understand that in a democratic nation like India, budgeting should conform to the principles of citizen participation and accountability

## 2.2 Introduction

This unit discusses the concept of budgeting in India. Budgeting is the process through which the Budget is prepared. The term "Budget" comes from the French word- "bougette" which means a leather bag or wallet. In the words of Dimmock, "A Budget is a financial plan summarizing the financial experience of the past stating a current plan and projecting it over a specified period of time in future". This unit elaborates on the concept of budget, its types, its principles and objectives in the context of India, the process in which a budget is prepared in India along with an analysis of how the process of budgeting should be made more participative and accountable in the nation being in tune with democratic principles.

What is a budget?- principles and objectives of budgeting in India- analysis of past budgets – their principles

A budget is a financial plan for a specified period of time, usually a year that includes the estimation of the revenue and expenditures of the government. Estimation of revenue includes the resources and income mobilized from different tax and non-tax revenues. Expenditures include expenses to be made for various programmes, projects, schemes d other public activities of the government. Therefore a budget is basically a plan of the government regarding how to collect revenue and where to use the same for public benefits. However a budget also contains statistical data regarding the financial performance of the government in the preceding year. The period for which the budget is prepared is known as the financial year. In the beginning of such a financial year, the government presents before the Lok Sabha the annual financial statement that shows an item wise estimation of the revenue expected and the expenditures anticipated. The financial year in India begins from April and ends in March in the next year.

The financial plan for a year is generally prepared keeping in mind the objectives of the government towards the economic development of the nation. Therefore the budget is prepared in such a way that a balanced and sustained growth in the economy is enabled. This entails an increase in the Gross Domestic product (GDP) of the nation. This stable economic growth is to provide for an enhanced standard of living for the citizens of the nation. Budget has its aim also to ensure equality and social justice in the nation. As such, eradication of poverty, problems of unemployment, reduction of inequalities, redistribution of income, provision of basic services to the people involve major objectives of how to utilize the financial resources of the nation.

In India, budgets have been prepared since independence and these have tried to cater to the objectives of ensuring economic growth and social justice in the nation. What follows is a brief analysis of the principles and objectives that guided Indian Union budgets since Independence-

In the pre-liberalization era, budgets in India were broadly determined by the following principles and objectives-

1. Self sufficiency in food production, defence services and civil expenditures. Development of the agricultural sectors and the public enterprises.
2. The after effects of partition and natural calamities affecting many parts of India at this time determined the objectives of budget which were- reintroducing food control, increasing supply of food grains at fair price and limiting food imports from overseas. Along with these many development projects were conceived which were to be sanctioned through loans to be taken from IBRD and IMF.
3. Formulating plans that could utilize the nation’s resources in the most effective way.
4. Development of the education sector including provision of grants to states for basic, secondary and university education and provisions for scholarships to students belonging to the Scheduled castes/classes and other backward classes.
5. Increase expenditure on development, production, expenditure and investment along with the savings rate of the common man.
6. To provide for export promotion.
7. To provide for greater participation of citizens in enabling the growth of industry.
8. There was an attempt to make budgets more people-centric which included social welfare and pension schemes.

9. Provision of employment opportunities, encouragement of small enterprises and entrepreneurs.
10. To ensure rural and urban development.
11. Launching of Farmers' service societies to provide credit to farmers to enable processing and marketing their produces.
12. Improvement of socio-economic conditions of the vulnerable sections in the society like the Scheduled Castes.

Budgets in the post-liberalization period was guided by the following principles and objectives-

1. Rapid technological development was ensured
2. Public expenditure on social welfare and infrastructure was emphasized on.
3. To promote India as major software development centre in the world.
4. Budgets were designed to be pro-poor.
5. Budgets were also designed to ensure inclusiveness and sustainable development.
6. Priorities were given to the development of youth and women.

What can be deduced from the above discussion is that the principles and objectives guiding budgets in India emphasized on a development that would ensure social justice and improved standard of living in the nation.

i. Types of Budget in India

According to Bhagwan and Bhushan (2014), classification of budgets can be done on the basis of the following principles- (i) the period covered
(ii) Number of budget introduced in the legislature
(iii)The overall financial position depicted in the budget
(iv) The principle adopted in taking the items of income and expenditure in the budget
(v) The classification of the receipts and expenditure in the budget.

In India, budgets are of three types- balanced budget, surplus budget and deficit budget.

Balanced Budget-

The Budget is said to be balanced when there is parity between the estimates of expenditure and the estimates of income. Under such circumstances there exists financial stability. However the situation of a balanced budget may pave hindrance in the way of undertaking more of social welfare activities by the government. However, "the ideal stand is that the government must increase its spending to bridge the gap between the expenditure that is needed to sustain full employment and the actual spending" (https://www.businessinsider.in/here-are-the-types-of-government-budgets-in-india/articleshow/67698823.cms).

On the other hand the Budget becomes unbalanced when the estimated spending of the government exceeds or is less than the estimated income of the government.

Surplus Budget-

A Budget is surplus when the estimated expenditure is less than the government's income. Such a budget indicates that the government draws more money from the economy than what is pumped into it.

Deficit Budget-

Contrary to the Surplus Budget, in a Deficit Budget, the estimated expenditure of the government exceeds the estimated income. It is believed that a deficit budget "is the most common kind of budget presented by the most popular democracies in the world today. This is done to meet the growing needs of people". It has the advantages of mitigating conditions of unemployment and recession.

ii. Process of Budgeting in India-

The process of budgeting in India goes through the following process-

1. Preparation of the Union Budget
2. Enactment of the Union Budget-
    i. Presentation of the Union Budget to the Parliament
    ii. General discussion on Union Budget in both the houses of the Parliament
    iii. Detailed discussion on the Budget in Lok Sabha and demands for grants by some ministries
    iv. Scrutiny of the demand for grants by the standing committees
    v. Voting for the demand for grants
    vi. Appropriation and Finance bills are passed
3. Execution of the Budget
4. Oversight of the Budget after being passed

1. Preparation of the Budget-

The Union Budget is known as the Annual Financial Statement and as it is prepared it contains of many parts which will be discussed shortly. Before that it is imperative to understand the procedure for the preparation of the budget. At first, a preliminary estimate is prepared by the heads of the local offices who are the disbursing officers. These estimates are scrutinized and reviewed by Controlling officers. Such revised estimates are further scrutinized and reviewed by the Accountant General and the Administrative department which are now reviewed by the Ministry of Finance. These estimates receive final consideration from the Union Cabinet after which the Budget is prepared to be presented before the Indian Parliament.

The estimates are nothing but an estimate of the expenditures and revenues of the government for the upcoming financial year. After this estimate of expenditure and revenue is prepared, these are matched so that any gap between the two can be identified. The shortfall is corrected by revising tax rates or internal and external borrowings as it is deemed feasible. After the deficit is narrowed the budget on acquiring its final shape is ready to be presented before the Parliament.

The Budget consists of the following documents-

Summary documents-

- Budget speech- It consists of the main tax and expenditure proposals

- Budget at a Glance- this specifies briefly the total funds that the government has acquired through taxation and borrowing and how this fund is to be spent and the budget deficit or surplus is to be corrected.
- Annual Financial statement

Expenditure documents-

- Expenditure Profile- It is a summary of all the total expenditures of the ministries. This also presents a category wise breakdown of various expenditures at present.
- Expenditure at Budget- This is a presentation of a detailed breakdown of expenditures of all the ministries.
- Demands for Grants and Appropriation Bill- These documents are constitutionally granted to be prepared so that the Parliament can provide the grants as demanded by various ministries for many programmes or schemes. These have to be voted for in the Parliament to be passed.

Receipts documents-

- Receipts Budget- It specifies in a detailed manner how the government deems to raise revenue from different sources.
- Finance Bill- It is a bill which has to be presented to the Parliament so that amendments can be brought about to introduce changes in tax structures as proposed by various ministries.
- Memorandum on the Finance Bill- This document explains the provisions in the Finance Bill in simple language.

FRBM documents-

- Macro-Economic framework- This contains the prospect for the economic growth of the country.
- Medium-term Fiscal Policy- This specifies targets for tax and non-tax receipts and control of budget deficits.
- Fiscal Policy strategy- It presents a statement that specifies the following of sound fiscal policy.

2. Enactment of the Union Budget

As the budget is presented to the Union Parliament, a general discussion is held on it by both the houses- Lok Sabha and Rajya Sabha. General discussion is limited to just an examination of the proposals of the different ministries. After this phase of general discussion, the estimates of expenditures by different ministries as presented in the Annual Financial Statement which are called Demand for grants as explained above are examined in a detailed manner by Parliamentary Standing Committees. These standing committees comprise members from both the Lok Sabha and the Rajya Sabha. Standing committees examine "(i) amount allocated to various programmes and schemes under the Ministry, and (ii) trends of utilisation of the money allocated to the Ministry" (overseeing public funds). After such examination which may require the ministries to attend to the queries of the committees or by taking recourse to expert advice, a report is submitted to the Parliament. These recommendations of the standing committees are useful for discussion in the parliament as to approval of the grants demanded by various ministries before voting on these.

Generally, the Lok Sabha discusses four or five demands for grants of particular ministries. The ministries whose demand for grants will be discussed are decided by the Business Advisory Committee of the Parliament. This discussion is proceeded voting on the grants and therefore their approval or disapproval. Disapproval is expressed through "cut motions" which if passed signifies a loss of confidence on the government leading the cabinet to dissolve. Cut motions can be moved to reduce the amount of grants demanded by ministries. These cut motions are expressed by- "(i) to Re 1 to signify disapproval of the policies of that ministry, (ii) by a specific amount (an 'Economy' cut), or (iii) by a token amount of Rs 100 to express a specific grievance".

After the grants are voted for, these are consolidated into the Appropriation bill which authorizes the government to spend money for the specified expenses from the Consolidated Fund of India. The Consolidated Fund of India consists of all the receipts and borrowings of the government. The Appropriation bill is passed in the Lok Sabha after which the Finance bill is also taken up for consideration and passage. After the bills are passed in the Lok Sabha, these go to Rajya Sabha which can only provide recommendations to these but constitutionally is devoid of making any changes to these.

3. The Execution of the budget

The Executive is responsible for the Union Budget to be executed. There are two principles which are followed in the execution of the budget. These are- "(i) it must confirm to the terms of the Appropriation and Finance Acts; and (ii) That there must be a high degree of honesty, integrity and efficiency" (process). In the process of execution, first the assessment and collection of funds are done by two statutory committees- Central Board of Direct Taxes and Central Board of Excise & Customs. The Reserve Bank of India (RBI) and the State Bank of India (SBI) are the custodians of public funds in India who disburse the funds.

4. Oversight of the Budget-

Although the Executive is responsible for the execution of the Union Budget, the Legislature continues to scrutinise the utilization of the funds in the most appropriate manner as sanctioned by the Parliament to various ministries. Such scrutiny is undertaken by two financial committees of the Parliament- Public Accounts Committee (PAC) and the Estimates Committee.

The Controller and Auditor General (CAG) of India is constitutionally vested to audit and present a report to the Parliament on the income and expenditure accounts of the Government. The Public Accounts Committee is responsible to examine the findings of the audit report of the Controller and Auditor General. The principal function of this committee is to scrutinise if the government has spent the money according to the purpose for which the fund was sanctioned. The Estimates committee has the function to- "(a) report on the improvements and administrative reforms that can be made, (b) to suggest alternative policies in order to bring about efficiency in administration, and (c) to suggest whether the proposed expenditure is within the limits of government policy" (overseeing public funds).

### iii. Analysis- transparency and participation in Indian Budgeting

Public participation in the Indian Budgetary process is an important matter of debate because "To help ensure that services respond to citizens' needs and are of good quality, citizens – the recipients of services – must engage throughout the budget process" (Duggal et al. 19). According to the open Budget Index which is a study by the IBP, "India provides citizens with "some information" on the central government's budget and financial activities, while some countries, such as France, the US, South Africa, New Zealand, the UK, and Slovenia, provide "extensive information" to their citizens." (Bhanu, 1079). There exists transparency as to the budgetary process in India and opportunities exist for the public to participate in the same. Some civil society organizations are working to make the Budget pro=poor- "Developing Initiatives for Social and Human Action (DISHA) is perhaps the pioneer organisation in India working on budget analysis with perspectives for marginalised sections of people. There are other organisations like the Public Affairs Centre, Centre for Budget and Policy Studies, Samarthan Centre for Budget Studies, Centre for Budget and Governance Accountability (NCAS programme), Social Watch Tamil Nadu, and Budget Analysis Rajasthan Centre, which work on budget analysis mainly with the viewpoint of the social sector and other sectoral issues" (Bhanu, 1079).

However it is certainly put forward that "the government should increase public participation in the budget formulation process and publish a pre-budget statement to facilitate this. Second, the government should strengthen sub-national budget transparency. Third, the government should mandate civil society participation in the planning and budgeting of programmes that directly benefit citizens through service delivery" (Duggal et al 19). The Fourteenth Finance Commission is a great attempt towards introducing greater transparency, accountability and public participation in the budgetary process of the country. It specifies how transparency and accountability of the budget can be ensured through measures like introducing pre-budget statement, sub-national transparency and greater civil society participation.

A pre-budget process signifies the release of the budget strategy of the government for the upcoming year ahead of the presentation of the draft budget in the Parliament. This pre-budget statement should provide for formal opportunities for the engagement of civil society, legislative members, media, and business in the discussion of resource allocation and policies to be introduced. Inputs from these sectors certainly will enable more public participation in the budgetary process. Publication of information on the plans of government on broad sectoral allocations, tax and non-tax reforms and fiscal objectives will provide enough scope for greater public debate so that inputs coming from such debates find place in the draft budget presented.

The simple release of budget documents to the citizens does not ensure participation from them in the budgetary process. Provision of relevant, accessible and timely information to citizens which are of personal interest to them like allocation of funds for the improvement of schools, roads and such sectors may induce public discussion on these issues. This has greater scope for the ordinary citizens and local civil society organizations to engage more in providing inputs to the budget. There are instances of civil society participation in budget formulation- "The peoples planning initiative in Kerala, wherein planning and budgeting for about 40% of the development budget is done directly by gram sabhas and other citizen committees.. In Nagaland, the village development committees (VDCs) engage directly with local development and budget allocations” (Duggal et al: 21`). However, more such initiatives are required if more accountability and transparency have to be achieved in budgeting.

Towards this end, Duggal et al lay out some recommendations based on the report of the Fourteenth Finance Commission

“Recommending the publication and dissemination of a pre-budget statement and related budget information that will increase civil society and legislative participation in formulation of budgets;
• Further, to strengthen the quality of budget information in line with Sundaramurti Committee recommendations, grants would be required for upgrading institutions, particularly the treasury management system in the country;
• Developing a rational basis for increased and effective allocation of resources to the social sectors so that the objectives of
the programmes are effectively achieved.
• Grants for institutionalized mechanisms with respect to better access to and dissemination of quality budget information
at the sub-national level, especially district
and sub-district levels.
• Making mandatory civil society participation for planning and budgeting (like PIPs, untied funds, etc) for programmes which directly benefit citizens through service delivery and benefits.” (Duggal et al., 22)

## 4.Conclusion

The discussion in the previous sections attempted to cater to the objectives of this unit. It explained the concept of a budget and explored the principles of Indian budgeting by unearthing the objectives and functions towards which the annual Indian Budgets were guided. It could be concluded that Indian budgeting has been focussed towards ensuring a development in the Indian economy which could uplift the standard of living of its citizens and ensure social justice.

The Budgetary process in India is a long drawn affair as has been explained in detail. The process of budgeting in India primarily starts with the finance ministry and involves the Parliament in sanctioning the final budget as prepared. An important aspect of budgeting in India is that the Budget in working is left for scrutiny by constitutional requirements.

However it has been observed that budgeting in India has to acquire more accountability at a preparation stage along with robust participation of the people.

## 5. Summary

1. A budget is a financial plan for a specified period of time, usually a year that includes the estimation of the revenue and expenditures of the government.
2. The financial plan for a year is generally prepared keeping in mind the objectives of the government towards the economic development of the nation.

3. Budget has its aim also to ensure equality and social justice in the nation.
4. The principles and objectives guiding budgets in India emphasized on a development that would ensure social justice and improved standard of living in the nation.
5. In India, budgets are of three types- balanced budget, surplus budget and deficit budget.
6. The Budget is said to be balanced when there is parity between the estimates of expenditure and the estimates of income
7. On the other hand the Budget becomes unbalanced when the estimated spending of the government exceeds or is less than the estimated income of the government.
8. The process of budgeting in India passes through the following stages- Preparation of the Union Budget, enactment of the Union Budget, execution of the Budget and oversight of the Budget after being passed.
9. There exists transparency as to the budgetary process in India and opportunities exist for the public to participate in the same. However it has to be more robust bringing out pre-budget statements for public scrutiny and enough civil society engagement in the process.

## 6. Keywords

Annual Financial Statement, Economic development, Social Justice, Lok Sabha, Rajya Sabha, Accountability, Public Participation,

## 2.10 Model questions-

1. What is meant by budgeting? (6 marks)
2. What are the principles guiding budgeting in India? (12 marks)
3. What were the guiding principles of the Union Budget in India in the pre-liberalization era? Was there any difference in principles guiding the Union Budget in the post-liberalization era? (18 marks)
4. Explain the types of Budgets in India (6 marks)
5. Elaborate on the content of the Indian Budget (6 marks)
6. Explain the process of budgeting in India (18 marks)
7. What happens after the budget is passed in India. Elaborate on the process of oversight of Indian budget (12 years)
8. How can public participation be enhanced in the process of budgeting in India? (12 marks)

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## Unit 3

## Resource Mobilization

STRUCTURE

3.1 Objectives
3.2 Introduction
3.3 Resource Mobilization in India
3.4 Tax revenues- Income Tax, Corporation Tax, Goods and Services Tax
3.5 Non-tax revenues
3.6 Conclusion-how the discussion fulfilled its objectives
3.7 Summary
3.8 Keywords
3.9 Model Questions
3.10 References and further Readings

### 3.1 Objectives-

The objectives of this unit are-

- To identify the sources of revenue in the country
- To identify the diversity in the sources of revenue generation in the nation
- To analyse the scope and potential of tax based revenue sources in the nation

- To analyse and scope and potential of non-tax based revenue in the nation

## 3.2 Introduction-

This unit discusses the issue of resource mobilization in India which essentially refers to how revenue is generated in the country by the government so that the developmental activities of the nation can be funded. Revenue in the country is generated by virtue of taxation and other methods. Taxation refers to a compulsory charging a portion of the income from individual citizens and institutional units in the nation. This power of taxation is granted to the Central government, state governments and municipal units with their scope being delineated by the constitution of India. The government can tax its citizens and institutional units either directly or indirectly. Direct taxes are those which are levied on the incomes and profits of the citizens and organizations while indirect taxes are levied on goods and services. Apart from tax based sources, the government collects its revenues from sources which are non-tax in nature. This includes charging citizens for various services that the government provide to them.

The discussion in this unit covers an analysis of how resource mobilization takes place in the nation through tax and non-tax means. It starts with an analysis of tax based revenue sources of the government. Here some taxes as levied by the government are specifically discussed. This includes one tax which is direct and is levied by the Centre- Income tax, one tax which is direct and is levied by states- Corporation Tax, one tax which is indirect and is levied by states- Goods and Services Tax, and one tax which is direct and is levied by Municipal bodies- Property tax. In discussing each of these tax based revenue sources, the potential of these towards revenue generation is analysed.

The discussion then proceeds towards an analysis of the potential of non-tax based revenue in the nation. Thereafter it is followed with concluding remarks and a summary of the entire discussion.

## i. Resource Mobilization in India

Resource mobilization refers to the generation of income or revenues by the Government of any nation, in the present case of India so that the various investments and expenditure requirements in the nation can be met. Revenue is generated in the country by means of taxation. However there are other sources of resource mobilization which are essentially non-tax in nature. What follows is an exhaustive discussion on the scope of resource mobilization in India by means of tax and non-tax sources.

Taxes in India can be levied by the Central government and the state governments as guaranteed and specified by the constitution of India. Local self governments like the Municipal bodies are also given some powers as to levying of taxes. Some tax based revenues and their scope which will be discussed in this unit are- income tax, agricultural income tax, corporation tax, excise duties and customs duties As mentioned there are other non-tax revenues of the government, some of these will also be dealt with as the discussion proceeds.

### ii. Tax based revenues

### Income Tax

Income tax is a tax that is levied on incomes and profits of individuals and firms. It is an inevitable imposition on the incomes of the citizens of the country by virtue of which the development needs of the country can be funded. It may be defined as “taxes on the non-agricultural incomes of three types of assess: Individuals Hindu Undivided families, unregistered firms and other associations of persons” (Gupta 2009)

Income tax is regarded to be a very important source of revenue for the Indian government. However revenue generated from income tax remains low in India. Following Richard Goode, certain conditions which are required for the income tax to be used as a potent source of revenue is not compatible to the Indian scenario. These are- “ the existence of a predominantly money economy, a high standard of literacy, prevalence of honest and reliable accounting, a large degree of voluntary compliance on the part of tax payers, a political system not dominated by wealthy groups acting in their self-interest, and honest, reasonably efficient administration” (Rajeev). The lack of buoyancy in generating enough revenues from income tax in India can be attributed to factors like no proper coverage of the working population, exceptions and deductions in levying income tax and large scale exemptions from income tax.

However measures have been taken in the nation owing to various tax reforms for increasing revenue generation from income tax. Reforms in tax structure have led to better results in terms of revenue generation from income tax. Income tax is designated to have enough potential for contributing generously to the total revenue of the Country. This is because the number of taxpayers has evidently increased over the years. It is observed that simplification of tax rate and broadening of tax base will positively impact upon more generation of revenue from income tax.

Revenue responsiveness from income tax can be further increased if the following factors are considered-

- Reduction in top marginal rate of Personal Income tax.
- Reduction in the number of tax slabs, thereby resulting in the simplification of tax structure.
- Increasing compliance through wider coverage of tax assesses in terms of PAN, TDS and TIN.
- Increase in the number of tax assesses.
- High GDP growth rate. (Gupta 2009).

### Corporation Tax

Corporate tax is another important means of generating revenue in the country. Tax levied on the profits of joint stock companies is referred to as corporate tax. Corporate tax is also a necessary imposition as “a corporation tax is also needed to prevent retained profits from escaping taxation, because they would not be included in the income of shareholders” (Rajeev).

However with regard to India, the corporate tax structure is very complex. In the words of V.G Rao, “An examination of the overall corporate structure system and changes that have been attempted over the period leads to the inescapable conclusion that the structure is a maze of complexities and confusion. This is a result of the frequent changes that have been practiced with respect to the revenue code, in the name of disallowances, partial or total, concessions and incentives, and the differentiation of companies on the basis of the class, status and size. No doubt, discretionary tax changes are essential for meeting revenue emergencies. But too frequent changes are unhealthy and at times prove uneconomical. They lead to greater uncertainty in tax administration and creation of tax loopholes.” (Rajeev)

Reforms have been undertaken with regard to the corporate tax structure in order to ensure its efficiency. Recently the present finance minister- Nirmala Sitharaman has claimed that the corporate tax rate will be reduced from its present rate which is 30% to 22%. Also the corporate tax rate for firms which receive no incentives or exemptions will be reduced from 35% to 25%. Again the corporate tax of manufacturing firms will also be cut from 25% to 15%. This initiative is taken so that a reduced corporate tax rate can move up investments and give a boost to the Indian economy that is faltering. A Prasanna who is the head of ICICI in Mumbai claims that this tax reform is a positive move towards the simplification of the corporate tax structure and this would lead to an increase in investments and jobs (https://www.bbc.com/news/business-49764964)

B.K Goenka, the president of Assocham claims with regard to the tax reform- “The corporate tax cut is the single biggest reform in the last two decades.. This is hugely competitive as compared to India’s closest manufacturing rivals like Vietnam, Indonesia and Bangladesh. I believe it would be a great catalyst to the Make in India programme for attracting foreign investment. The timing is also perfect as this comes at a time when key American companies are caught in a trade war with China and are looking at alternative global manufacturing bases”

### Goods and Services Tax (GST)

Goods and Services Tax is designated to be the outcome of the greatest reform in the taxation regime of the country. Introduced in 2017 the GST subsumes seventeen indirect taxes under its domain including the excise duty and sales tax. GST is “currently levied on every product except petroleum, alcohol, tobacco and stamp duty on real estate in four slabs of 5, 12, 18 and 28 per cent. Most of the daily use articles have zero GST as per the latest revision of the tax rates last year (https://www.indiatoday.in/india/story/2-years-of-gst-hits-misses-and-future-1559678-2019-07-01)

It has been observed that owing to this reform, the revenue base has gone up significantly- “The average revenue collection per month in the eight months of 2017-18 was Rs 89,700 crore per month. This propelled the annual revenue collection by about 12 per cent…The monthly average revenue collection increased further in 2018-19 by about 10 per cent to Rs 97,100 crore” (https://www.indiatoday.in/india/story/2-years-of-gst-hits-misses-and-future-1559678-2019-07-01). However the revenue collection targeted from GST has not been fulfilled-“ In 2018-19 Budget, the GST collection was estimated at Rs 7.4 lakh crore which was revised later in 2019-20 interim budget to Rs 6.4 lakh crore. But the finance ministry's figures show that the actual GST collection for 2018-19 was around Rs 5.8 lakh crore, a significant shortfall of over 20 per cent compared to budget projection" (https://www.indiatoday.in/india/story/2-years-of-gst-hits-misses-and-future-1559678-2019-07-01).

GST is believed to have enough potential for a lot of positive changes in the Indian economy. It has the potential to increase the price of agricultural produce, it could reduce the cost of manufacturing industries, it can bring down the cost of housing to the extent of embedded taxes thereby being beneficial to the poor. Also the GST is so designed that it could lead to reduction of poverty in the country- " At present, primary food articles like rice and wheat are liable to tax by many States either by way of purchase tax or sales tax at a lower rate. But under the GST, all food items covered under the public distribution system including rice and wheat are proposed to be exempted. As a result primary food articles like rice and wheat would be exempted from GST. Since expenditure on food constitutes a large proportion of the total consumption expenditure of the poor, the GST is designed as a poverty reduction initiative. Like food, basic health and education services are also intended to be fully exempted. In any case, as at present, these services will continue to be exempted from tax and therefore no additional burden will arise on account of the switchover to GST" (Thirteenth Finance Commission referred to in Vasanthagopal 2011: 145). GST also hold potential for increasing income and output of various sectors. This in turn would lead to increased employment opportunity.

Most importantly, GST would enhance revenue generation and thereby resource mobilization of the government. As Vasanthagopal argues- "Since all goods and services would be under the purview of GST, it is expected that the number of exemptions would reduce very much. Again, the tendency of tax evasion by producers and distributors will be low as to the single (or dual) and low rate of tax proposed under GST. Further, increased GDP, indirect positive impact on direct tax collections, gain for the government on account of reduction in the price level of a large number of goods and services consumed by the government as a result GST etc. a flawless GST would trigger an increase in the government revenue" (Vasanthagopal 2011: 145-146).

What is required for the Goods and Services tax to act to its potentials is a flawless and rational designing and implementation of this tax reform.

### iii. Non-Tax Revenues of the Government

Besides generating revenue from taxation, the government in India also collects revenue from sources which are non-tax in nature. There exists wide range of non-tax revenue sources for the government in India- "when people avail services offered by the government, like electricity, telecommunication, DTH, broadband etc, they pay bills, which include the share of non-tax revenue as the government provides infrastructure support to facilitate the services. The government also collects interest as non-tax revenue on the loans and funds advanced to states for various purposes. So, the government collects non-tax revenue in return for providing/facilitating any goods or services" (https://www.financialexpress.com/what-is/non-tax-revenue-meaning/1762795/)

It is believed that non-tax sources could become a more important source of revenue generation for the government in India that tax based sources. This is because in the wake of globalization the government will be losing its ability to tap important tax bases and therefore greater attention has to be paid to generation of revenue from non-tax based sources. Some scholars claim "these bases include increasingly mobile capital, skilled labour and footloose industries. Reduced government bargaining power will lead to decreased taxation of these bases, a trend that has already begun and of which several telling examples are to be found both in developed and developing countries" (Dasgupta: 1).

In order to analyse the contribution of non-tax based sources to revenue generation and therefore resource mobilization in India, it is important to understand the definition and scope of such non-tax revenue sources in the country. Arindam Das Gupta makes a significant attempt towards this end. Taxes are compulsory, unrequited payments made by individual citizens and institutional units to the government in either cash or kind. Non-tax revenues sources may be compulsory and requited, voluntary and unrequited and voluntary and requited.

Earmarked taxes, fines or penalties are examples of compulsory requited payments. Earmarked taxes refer to tax receipts from state budgets like Government of India's education cess. Fines and penalties are accounted for as both tax receipts and non-tax receipts. Earmarked taxes may act as substitutes for user charges as user charges are often difficult to collect. Bird identifies sources which can be earmarked. These include taxes to fund social security schemes, fuel taxes for roads, pollution levies for protection of environment and the likes. Fines and penalties are accrued from citizens who break the laws. Fines should however conform to the particular crime committed which indicates that fines should not be exceeding the crime. Dasgupta puts forward the design for fixing fines and penalties for non-compliance to the law of the land- " 1. Penalties for lesser degrees of non-compliance should, following the principle of marginal deterrence, be less than the marginal social loss so that citizens have the incentive to substitute away from higher levels of non-compliance 2. The procedure for levy of penalty should be transparent and not subject to administrative discretion. 3. Penalties for corruption or inaction by bureaucrats and political representatives should be high enough to reduce opportunities for non-compliant citizens ("gainers") to compensate bureaucrats or representatives who are punished" (Dasgupta: 6).

Voluntary and unrequited payments include those payments which are made as contributions to the government. One example is contribution made to Prime Minister's Relief fund. Other examples are gifts and donations to the government which however are not major sources of income. Besides this, unclaimed dues are also voluntary and unrequited payments to the government which come as windfall gains. This contributes almost negligibly to the government revenue. However "The key question is to what extent rigidities in government procedures and red tape impede recovery of dues from the government by citizens. Greater hurdles cause them to become arbitrary involuntary and unrequited payments or, that is, arbitrary taxes. In case of such hurdles, any growth in these receipts should be viewed as a decline in the effectiveness of non-tax revenue performance" (Dasgupta: 7)

Non-tax revenues which are voluntary and requited can be further classified into revenue coming from assets, revenue coming from the sale of goods and services and revenues accruing from the sale of licenses and permits for regulated activities. Revenue from assets includes sources like property resources of the government. Examples can be given of forest, wilderness, marine habitats, exhaustible or renewable natural resources which are not granted private property rights and assets created from government investments like public sector undertakings, roads, irrigation, infrastructure capitals and the likes. Revenue accrued from exhaustible and renewable resources happen to be the most important source of non-tax revenue in many states in India.

Revenue from the sale of goods and services include sale of infrastructural services which are known as user charges. When the public is charged for utilizing government services, these charges go to the government in form of user charges and designated as an important source of non-tax revenue. Goods and services which can be considered chargeable by the government may possess characteristics like "(a) excludability, (b) congestibility (or rivalness), (c) geographical coverage (or localness), (d) external effects, (e) private information about the good, (f) supply risk and (g) lumpiness or economies of scale" (Dasgupta: 7). Charging for Goods and services possessing these characteristics are deemed to be socially desirable and acceptable.

Revenue from licenses and regulated activities include business and shop licenses, construction and land use permits, examination and inspection fees and the likes. However this source is not considered to be very important source of revenue in the current times in India.

Non-tax revenues in India form an important source of revenue for the government. There exist a vast number of sources under the category of non-tax revenue. A broad classification as provided by Arindam Dasgupta has been presented in the above discussion.

## 4. Conclusion-

The above exhaustive discussion on resource mobilization in India could fulfil the objectives of the unit. It could identify the sources of income for the government both tax and non-tax based. It analysed how taxation being an important source of revenue generation do contribute generously to resource mobilization in the nation. However there exists some discrepancy in the taxation regime which if rectified can increase the buoyancy of these taxes. For instance, the coverage of income tax must be enhanced and tax evasion from income should be kept in check. Again the structure of Corporation tax should be made simpler and more effective. Also the Goods and Services Tax (GST) should be implemented in a rational manner. As for non-tax based revenue generation, the scope of non-tax revenues should be understood.

It is only by this that resource mobilization can be appropriate and efficient to the cause of development and growth of the nation.

## 5. Summary-

- Resource mobilization refers to the generation of income or revenues by the Government of any nation, in the present case of India so that the various investments and expenditure requirements in the nation can be met
- Revenue in India is generated through taxation
- Taxes are direct like income tax and indirect like Goods and Services Tax (GST)

- Taxes can be levied by centre like income tax, by states like Goods and Services Tax (GST) and by Municipalities like Property tax
- Income tax is regarded to be a very important source of revenue for the Indian government. However revenue generated from income tax remains low in India
- It is observed that simplification of tax rate and broadening of tax base will positively impact upon more generation of revenue from income tax
- Tax levied on the profits of joint stock companies is referred to as corporate tax.
- The corporate tax structure is very complex. Measures have been taken to reduce the tax rate and hence simplify its structure.
- Goods and Services Tax is designated to be the outcome of the greatest reform in the taxation regime of the country. This tax has a lot of potential in raising the revenue but it must be implemented rationally.
- Besides generating revenue from taxation, the government in India also collects revenue from sources which are non-tax in nature
- It is believed that non-tax sources could become a more important source of revenue generation for the government in India that tax based sources
- Non-tax revenues sources may be compulsory and requited, voluntary and unrequited and voluntary and requited.
- Earmarked taxes, fines or penalties are examples of compulsory requited payments
- Examples of voluntary and unrequited payments are contributions to government, gifts and donations.
- Non-tax revenues which are voluntary and requited can be further classified into revenue coming from assets, revenue coming from the sale of goods and services and revenues accruing from the sale of licenses and permits for regulated activities

6. Keywords

Resource mobilization, revenue, Tax based revenue, noon-tax based revenue, Income tax, Corporation Tax, Goods and Services Tax, User charges

3.9 Model Questions-

1. How is resource mobilization done in India? (6 marks)
2. What are the various sources of revenue generation in India? (12 marks)
3. How is taxation a potential source of revenue generation in India? (18 marks)
4. Analyse the scope of direct taxes as sources of resource mobilization in India (12 marks)
5. Analyse the scope of Goods and Services Tax (GST) as the greatest reform in India’s taxation regime in generating growth in India’s economy (12 marks)
6. Explain the non-tax based sources of revenue generation in India (6 marks)

7. What is the scope of non-tax based revenues in contribution to resource generation in the country (12 marks)
8. Classify the types of non-tax based revenues in India (18 marks)
9. What are the voluntary and requited non-tax sources revenue in India (12 marks)

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Unit 4

## Deficit Financing

### STRUCTURE

4.1 Objectives
4.2 Introduction
4.3 What is deficit financing?
4.4 Effects of deficit financing in India
4.5 Solutions for controlling budgetary deficits
4.6 Conclusion
4.7 Summary
4.8 Keywords
4.9 Model Questions
4.10 References and Further Readings

### 4.1 Objectives

The objectives of this unit are-

- To understand the concept of budgetary deficit and deficit financing
- To know the effects of deficit financing in India
- To understand how the condition of budgetary deficit can be averted
- To know viable solutions to prevent budgetary deficit and hence deficit financing

### 4.2 Introduction

This unit discusses the concept of deficit financing. Deficit financing is a reaction of the government to the situation of budgetary deficit in the country. Deficit in the budget arises when the revenue of the government falls short of the expenditure. To order to cope up with this situation the government collects additional finances. This action of the government is known as deficit financing. The discussion in this unit starts with elaboration on the concept of deficit financing and the process of deficit financing in India. It then goes on to discuss the various effects of deficit financing in India. Thereafter the discussion ends by pointing out the various warnings of budgetary deficit in a country and viable solutions for preventing the negative impacts of deficit financing.

### i. What is deficit financing?

The budget of the government which is prepared for every year presents the estimated revenue and expected expenditures of the upcoming year. When the expenditure of the government is less than the revenue, there is a situation of budget surplus. On the other hand when the revenue falls short of the expenditure, there is a condition of budgetary deficit. The means undertaken by the government to finance this deficit is known as the phenomenon of deficit financing. The situation of budgetary deficit arises evidently when the expenditures of the government cannot be met through the normal sources of revenue like taxation and the likes. Under such circumstances, in order to meet the additional expenditures the government takes resort to other means which are designated as means of deficit financing. Deficit financing is done through borrowing from domestic or external sources, drawing upon the country's foreign exchange reserves or by printing money.

These measures have significant implications and therefore influence the economy- "excessive printing of money leads to inflation. If the government borrows too much from abroad it leads to a debt crisis. If it draws down on its foreign exchange reserves, a balance of payments crisis may arise. Excessive domestic borrowing by the government may lead to higher real interest rates and the domestic private sector being unable to access funds resulting in the „crowding out‟ of private investment. Sometimes a combination of these can occur. In any case, the impact of a large deficit on long run growth and economic well-being is negative" (De 2012: 4). Therefore the government has to prevent the condition of excessive budgetary deficit. This is not to say that budgetary surplus is a desirable phenomenon for a developing country like India. This is because in a developing nation there is a huge requirement for investment in infrastructural development and social welfare and having a surplus budgetary condition at the expense of long term growth is not a desirable situation. Therefore "The challenge then for most developing country governments is to meet infrastructure and social needs while managing the government's finances in a way that the deficit or the accumulating debt burden is not too great" (De 2012: 4).

As deduced from the above discussion, the need for deficit financing arises when there is a budgetary deficit. Deficit in the budget occurs as a result of many things. The primary reason for this is that there are certain elements in government spending which grow at a much higher rate than the rate of growth of tax receipts. Deficits in budget occur also when national emergencies have to be met. Other circumstances when deficits occur are when there are "shifts in government spending, changes in the competitive environment, globalization, presence of shadow economies, fraud in government programs, role of multinationals, and income distribution that affects private consumption expenditures" (Jadhav and Neelankhavil 2011: 86).

In India which is a developing nation, economic growth is a requisite. Economic growth certainly requires heavy expenditures from the government which the normal sources of revenue may not be able to match to. As a result of which the condition of budgetary deficit arises leading to the necessity for deficit financing. There are many conditions which may arise in the country making deficit financing essential. These are-

"To finance defence expenditures during war

ii. To lift the economy out of depression so that incomes, employment, investment, etc., all rise

iii. To activate idle resources as well as divert resources from unproductive sectors to productive sectors with the objective of increasing national income and, hence, higher economic growth

iv. To raise capital formation by mobilizing forced savings made through deficit financing

v. To mobilize resources to finance massive plan expenditure

If the usual sources of finance are, thus, inadequate for meeting public expenditure, a government may resort to deficit financing" (http://www.economicsdiscussion.net/public-finance/deficit-financing/deficit-financing-meaning-effects-and-advantages/17460)

In order to ensure deficit financing, in India additional finances are accumulated from three important sources- First, the central bank of the country which is the Reserve Bank in India gives credit to the government. Second, the government receives credit from commercial banks and other banks. Last, the government withdraws its cash balances from the Reserve bank of India. In all these three cases government receives the additional finances from the Reserve Bank of India (RBI). While the first and the third sources are evidently pointing towards money withdrawn from RBI, the second also indicates money from RBI- "in the case of the commercial banks investing in government securities, it is done so with the help of the cash reserves of the banks lying with the RBI. Cash reserves with the banks or with the RBI are not the part of money supply. So when the banks invest in government securities, their cash reserves with the RBI are debited in their accounts and credited to the account of the government and when the government spends this amount, the supply of the reserve money in the economy gets increased"

### ii. Effects of deficit financing in India

In order to cope with the situation of budgetary deficits, taking recourse in deficit financing has implication for inflation. Deficit financing raises aggregate expenditure which in turn pushes up the aggregate demand. This leads to inflation in economy. The inflationary potential of deficit financing can be explained through an example- Assuming the velocity of money in terms of units "Let the number of goods available for transactions be 1000 units and the initial money supply with the public Rupees 2000, government having no money. Now the government wants to have half the output that is 500 units of goods. It neither taxes people nor borrow from them; it prints Rupees 2000 worth of currency notes. The total money supply impinging on the unchanged stock of goods would now be Rupees 4000. The price under competition of people with the government will push the price of the commodity to Rupees 4 a unit. At the new price the public with their Rees 2000 would purchase 500 units of the commodity; with their money the government would take away the remaining 500 units of the commodity either for boosting production or for wading war. Thus, deficit financing will force society in real terms 500 units the government would use unleashing inflation in the economy" (Hasan 2018: 5).

Inflationary tendencies of deficit financing depend on what the additional finances are spent for. If it is for unproductive activities like war where no addition is made to the nation's wealth and no productive capacity of the society is enhanced, a situation of hyperinflation is created. On the contrary if deficit financing is undertaken for development expenditures, although money supply increases it may not lead to inflation. This is because investments in developmental activities lead to the increase in productivity. This can be an antidote against price inflation. Also the "most important thing about deficit financing is that it generates economic surplus during the process of development. That is to say, the multiplier effects of deficit financing will be larger if total output exceeds the volume of money supply. As a result, inflationary effect will be neutralized" (http://www.economicsdiscussion.net/public-finance/deficit-financing/deficit-financing-meaning-effects-and-advantages/17460) It is believed that a mild dose of inflation may be beneficial to the process of development in developing countries like India only if the rate of price rise is kept minimum and viable. Again "To ward off possibilities of getting inflation out of hand, effort is made to pull back the created money into savings' fold accompanied with a well managed system of price controls and rationing of wage goods" (Hasan 2018: 8). However such a system has potentials for creating black markets and corruption. Therefore such initiatives must be made according to ethical standards.

What immediately happens when deficit financing is resorted to is that money supply with the public increases. This increase in money supply results in many different things like a price inflation, or expansion in output and employment. The intensities of these will vary in different circumstances. This variation of intensity further is dependent on the actions of the public whose purchasing power increases as a result of increase in the money supply. The public with increased purchasing power may either hold money which is called liquidity preference, or may spend the money which is referred to their propensity to consume or may have inclinations towards investment which is designated as the investment-demand schedule. The behavioral pattern of the public owing to increased money supply however is also determined by fiscal and monetary authorities who decide on the quantity of money supply. For instance as a result of the decisions of fiscal authorities when money supply increases in the economy, it may bring up the income of the citizens in forms of wages, salaries, rents, profits and the likes. This evidently leads to an expansion of consumer spending. However not much expenditure of the government takes place in increasing the income of the citizens and therefore the rise in income subsequently becomes less. Yet this increase in income augments the productive process in the economy. This happens when the increased money in the hands of the public goes into savings which subsequently are used for business investments.

However as an effect of deficit financing the purchasing power of the public does not increase at an equal level. Deficit financing most evidently leads to inequality in income distribution. Deficit financing may lead to the creation of excess purchasing power. However this is combined with the inelasticity in the supply of essential goods resulting in rise in price. Under such a circumstance, the economically rich section benefits while the low income groups are disadvantaged. Thus deficit financing holds potential for propelling social injustice. However social justice can be kept intact under deficit financing if the additional finances are spent on public good and social welfare programmes.

However deficit financing also possesses the scope for inducing economic development. Economic development depends on capital formation which in turn depends on savings. In developing economies like India however has fewer saving to ensure enough capital formation. Under the circumstance of deficit financing led inflation, capital gets accumulated so that it can be utilized for economic development. Owing to such inflation the producers benefit more than the fixed income earning group. As a result of this aggregate savings increase which leads to capital formation leading to acceleration of economic growth. Again inflation caused by deficit financing has an impact on reducing consumption of the public. This leads to a condition of forced savings which may lead to capital formation holding potential for economic development. In less developed countries deficit financing is used to mobilize savings which can be used to increase capital. This "technique of deficit financing results in an increase in government expenditure which produces a favourable multiplier effect on national income, saving, employment, etc" (http://www.economicsdiscussion.net/public-finance/deficit-financing/deficit-financing-meaning-effects-and-advantages/17460) However if the resources remain underutilized the multiplier effect of deficit financing might not show positive results. Therefore deficit financing employed for economic development may not yield results due to many other factors like shortage of capital equipment, lack of technical knowledge and entrepreneurship, lack of communications, market imperfections and the likes.

India undertook the means of deficit financing in order to ensure economic development after independence during its initial planning years which could lead to positive outcome which however was not long lived - “The First Plan was designated largely to agriculture and irrigation; the second (1956-1961) aimed at industrialization and transportation, but agriculture got its due. Emphasis on expanding the public sector continued in view of the declared objective of establishing a socialistic social order. Emboldened by the success of the First Five Year Plan, the size of the Second Five Year Plan in outlay terms was raised to rupees 480 billion of which no less than rupees 120 billion or 25% was to be the deficit finance component. The two plans raised the GDP of the country at constant prices by 42 % and per capita income by 18% despite rapid increase in population. 30 years were also added to the life expectancy of an average Indian. Laudable achievements these were wherein deficit financing contributed significantly as a tool for resource mobilization” (Hasan 2018: 5). However this could not be continued as resources collected began to be diverted from development to defense needs owing to the Chinese attack on India in 1962.

iii.Solutions to problems of Budget Deficit

The situation of budgetary deficit leading to deficit financing may lead to development of the economy and might be resorted to as India has done. It however has inflationary tendencies which may have adverse effects in the long run. Therefore budget deficits must be kept in check and therefore deficit financing should be controlled. There may be indicators of fiscal deficit in the economy which have to be indentified if the situation has to be controlled. Jadhav and Neelankavil come up with come up with viable solutions which may be considered for preventing fiscal deficit when undesirable-

1. Expense reduction

The government must bring down its expenses if the situation of budgetary deficit has to be avoided. Expenditure cut should depend on the kind and amount of services to be provided by the government. However such reduction in expenses of central government should not pass down as burdens to state governments or local level bodies or even to individuals as this might lead to disparity between incomes of individuals and therefore distributional injustice.

2. Tax rationalization

The tax structure should be designed in such a way that the revenue requirements of the government are met to finance the essential expenses. A rational tax structure must be in place so that there is parity between consumption and investment requirements in the economy and also the reduction in income disparity- “The tax structure should have fewer taxable income groups with progressive flat tax rate levels. Such tax structure should also serve to reduce income inequality. Care should be exercised that reduction in federal taxes and expenses does not result in an increase in state and local taxes, because it will merely mean passing federal tax burden to state and local government with no relief in total taxes paid by individuals. Measures for stimulation of economy should integrate both expense reduction and tax rationalization measures” (Jadhav and Neelankavil 96)

3. Streamlining of regulations

Regulations should be brought about so that appropriate rules are functional in preventing activities like tax evasions. This will lead to no discrepancy in the revenue collection of the government and thus will be beneficial towards reducing fiscal deficit. Also “Foreign banks should be required to disclose the names and balances by individuals who have illegally transferred funds to avoid tax liability in home country” (Jadhav and Neelankavil 97)

4. Legislative limitations

If the legislative process in a country is improved it may result in better and effective implementation of measures to prevent the condition of budgetary deficits and national debt.

These solutions may be useful for India to contain excessive budgetary deficits leading to deficit financing in the nation.

4.Conclusion

The above exhaustive discussion could attend to the objectives of the unit as specified in the beginning. It dealt with the concept of deficit financing. It has to be understood that a budget deficit and deficit financing are not the same thing. Deficit financing is a response to the condition of budget deficit. The government in India has resorted to deficit financing as the country has witnessed deficit in its budgets. Although deficit financing has inflationary tendencies it also has some potential for ensuring economic growth. Developing countries like India therefore has resorted to deficit financing in augmenting the process of economic growth in the nation. However deficit financing may lead to distributional injustice which must be averted by using additional finances for development expenditure. In order to prevent the long term negative impacts of deficit financing early warnings that the economy portray towards a budget deficit must be attended to.

5. Summary

- When the revenue falls short of the expenditure, there is a condition of budgetary deficit. The means undertaken by the government to finance this deficit is known as the phenomenon of deficit financing.
- Deficit financing is done through borrowing from domestic or external sources, drawing upon the country's foreign exchange reserves or by printing money.
- Deficit in the budget occurs as a result of many things. The primary reason for this is that there are certain elements in government spending which grow at a much higher rate than the rate of growth of tax receipts.
- Other reasons include shifts in government spending, changes in the competitive environment, globalization, presence of shadow economies, and fraud in government programs, role of multinationals, and income distribution that affects private consumption expenditures.
- In order to ensure deficit financing, in India additional finances are accumulated from three important sources- credit from RBI, credit from commercial banks, taking cash balances from RBI.
- Deficit financing raises aggregate expenditure which in turn pushes up the aggregate demand. This leads to inflation in economy.
- Inflationary tendencies of deficit financing depend on what the additional finances are spent for. For unproductive purposes like war, deficit financing leads to hyperinflation.
- If deficit financing is undertaken for development expenditures, although money supply increases it may not lead to inflation because investments in developmental activities lead to the increase in productivity.
- Deficit financing holds potential for propelling social injustice. However social justice can be kept intact under deficit financing if the additional finances are spent on public good and social welfare programmes.
- India undertook the means of deficit financing in order to ensure economic development after independence during its initial planning years which could lead to positive outcome which however was not long lived.

- There may be indicators of fiscal deficit in the economy which have to be indentified if adverse effects of deficit financing have to be controlled.
- By undertaking the measures of expense reduction of government, tax rationalization, regulatory measures and improving legislative processes, adverse effects of deficit financing can be prevented.

6. Key words-

Budgetary deficit, deficit financing, government expenditure, inflation, economic growth, income disparity, distributional justice, tax rationalization

4.9 Model questions-

1. Explain the concept of deficit financing (6 marks)
2. What leads to deficit financing? (12 marks)
3. How is deficit financing undertaken in India? (12 marks)
4. What are the effects of deficit financing? (18 marks)
5. Elaborate on the inflationary tendencies of deficit financing. (12 marks)
6. Does deficit financing lead to economic growth? (12 marks)
7. How can budget deficit be controlled? (12 marks)
8. What are the indicators of a possible budget deficit in a nation? (6 marks)
9. What can be the viable solutions to prevent budget deficit? (18 marks)

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# Unit 5

## Role of Finance Ministry

STRUCTURE

5.1 Objectives
5.2 Introduction
5.3 Objectives
5.4 History
5.5 Structure and role of finance Ministry
5.6 Evaluating the achievements of Finance ministers
5.7 Challenges of Finance Ministry in India
5.8 Conclusion
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5.11 Model questions
5.12 References

## 5.1 Objectives

1. The objective of this discussion is to be acquainted with the evolution of the finance ministry in India
2. To understand the structure and functions of the finance ministry in India
3. To critically evaluate the achievements of the finance ministry in India
4. To understand the challenges that the finance ministry in India faces

## 5.2 Introduction

The finance ministry is one of the most important departments of the Indian government. Its significance is well recognized by the Haldane Committee (1918) - “The Department of Finance must necessarily have an exceptional position among all the State Departments. The service which it has to perform- that of supervising and controlling all operations of Government in so far as they affect the financial position… involves not only the direct administration of taxation and other branches of revenue but also the control of all forms of expenditure”.

This unit deals with the finance ministry in India. It elaborately discusses the evolution of the finance ministry in India. It elaborates on the structure and functions of the finance ministry in India. It also evaluates the performance of the finance ministry in India by exploring the achievements of different finance ministers also specifying the various challenges that this ministry faces in its operation.

## 5.3 History

The finance ministry in India is responsible for the financial, fiscal and monetary administration of the nation. The finance ministry as it exists today in its structure and functions has a long evolutionary history which should be referred to. The public department was bifurcated into Union company administration and the department of finance in 1810 headed by a single secretary till 1816. It was only in 1843 that the department of finance began to be headed by a separate secretary. With the administration of colonial India being passed over to the British crown since 1858, the finance department looked over also the matters related to trade and commerce. As such in 1979, the finance department was designated as the department of Finance and Commerce. However in 1905, it was renamed again as the department of Finance and its commercial and industrial functions were assigned to a new department of commerce and industry.

The finance department underwent many organizational redesigning over the years. Owing to the Morley-Minto reforms of 1909, and Government of India Act 1919, the finance department was divided into seven branches- general finance, revenue, Money and banking, Salary and allowances, Public accounts, Military finance and Military Accounts. As a result of the Montford reforms of 1919, the office of Comptroller and Auditor General was created and given statutory status. However it was the Secretary of State for India who actually exercised power with regard to the revenue and expenditure of the country being assisted by the finance department. The Government of India Act, 1935 stayed the power f the Secretary of State for India over Indian financial administration restricting the powers of the finance department. It was only in 1947 after the attainment of independence that the office of the Secretary of State for India was abolished. Now the department of finance acquired the designation of the Ministry of Finance. The Ministry was now organized into three major wings- Expenditure, Economic affairs and Revenue. In 1955 again the ministry was reorganized into four departments- Department of Economic Affairs, Department of Revenue, Department of Expenditure and Department of Company law Administration. A department of Coordination was added to the finance ministry in 1963. In the next year the function of the company law administration was taken over by a newly created department of Company Affairs and Insurance which was abolished again in 1966. The department of coordination was also abolished in 1967. In 1979, the ministry once again got reorganized now into four departments namely- Expenditure, Economic Affairs, Revenue and Insurance and Banking. Each of these departments was headed by a secretary to the government. The department of Banking was however merged with the department of Economic Affairs in 1985. Since 1990 till date the finance ministry comprises these three departments.

## 6 Structure and role of finance ministry

The Department of expenditure is the nodal department of the ministry which oversees the public financial management system of the Central government and the state governments. It implements the recommendations of the Finance Commission and the central Pay Commission. It monitors audit statements and prepares Central government accounts. To oversee the expenditure management in the central ministries and departments form one of its principal functions. As a part of this function, this department administers Financial Rules/ Regulations/ Orders and sanctions appraisal for major schemes and projects and also handles central budgetary resources which are transferred to the states. It also provides assistance to central ministries and departments so that these can control costs and prices of public services. It further reviews systems and procedure of these ministries for an optimal outcome of public expenditure. Such business of this department is carried out by its Personnel &Establishment Division, state and central divisions of Public Finance, Office of Controller General of Account, Office of Chief Adviser Cost, and Central Pension Accounting Office.

The Department of Revenue administers matters related to the Direct and Indirect Union Taxes. There are two statutory boards through which this department carries out such administration. These are- the Central Board of Direct Taxes (CBDT) and the Central Board of Indirect Taxes and Customs (CBIC).Each of these bodies are headed by a chairman who happens to be ex-officio special secretary to the Government of India. The CBDT looks after the matters pertaining to the levying and collection of Direct taxes and the CBIC administers matters pertaining to the levying and collection of Customs and Central Excise Duties along with other Indirect Taxes. This department also administers various Acts like the GST Act 2017, CGST Act, Income Tax act 1961, and others.

The department of Economic Affairs is responsible for monitoring the economic affairs of the nation and in advising the government on issues of domestic and external economic management and also regarding the functioning of commercial banks, regulation of investments. This department is also responsible for preparing the budget and in taking measures towards mobilization and allocation of resources in tune with the nation's developmental needs. It makes policies with regard to currency, banking, financial corporations, foreign exchange and private foreign investments.

The Ministry of Finance also comprises two additional departments- the department of Financial Services and the department of Investment and Public Asset Management.

The Department of Financial Services administers the functioning of banks, Financial Institutions, Insurance Companies and the National Pension System covering major reforms, initiatives and programs along with international banking relations. The finance secretary heads the department who is assisted by three Additional Secretary (AS), six Joint Secretaries (JS), two Economic Advisers (EA) and a Deputy Director General (DDG). This department also deals with the legislative and policy issues of the Reserve Bank of India (RBI), the Insurance Regulatory and Development Authority of India (IRDAI) and the Pension Fund Regulatory and Development Authority (PFRDA). Other institutions to which support is extended by this department includes public Sector banks (PSBs), Public Sector Insurance Companies (PSICs) and Development Financial Institutions (DFIs) like National Bank for Agriculture and Rural Development (NABARD), Small Industries Development Bank of India (SIDBI), India Infrastructure Finance Company Ltd. (IIFCL), National Housing Bank (NHB), Export-Import Bank of India (EXIM Bank), Industrial Finance Corporation of India (IFCI).

The department of Investment and Public Asset Management has its vision to effectively manage public investment in Central Public Sector Enterprises for promoting economic development. It also looks after the prosperity of the Central Public Sector Enterprises by inducing people's ownership of the former through disinvestment. This department also has its mission to "1. List CPSEs on stock exchanges to promote people's ownership through public participation and improving efficiencies of CPSEs through accountability to its shareholders. 2. To bring in operational efficiencies in CPSEs through strategic investment, ensuring their greater contribution to economy. 3. Adopt a professional approach for financial management of CPSEs in the national interest and investment aimed at expanding public participation in ownership of CPSEs."

## 7 Achievements of the Finance Ministry in India

The finance ministry is most evidently responsible for ensuring economic growth of the nation. To this end the finance ministry did contribute generously since the time India has gained independence. The Finance ministers of this country being at the helm of affairs of the ministry of finance have on many occasions undertaken steps that have led to achievements at the front of economic growth. India's economy stands at 2.6 trillion dollars and India is the fastest economy after China. Major goods and services are provided to the world from India. According to a report by IHS Markit, it is forecasted that India will take the second position in terms of economic growth in the Asia Pacific region just after Japan by 2025. The policies undertaken by many finance ministers have brought India's economic standards at this level. As such it becomes important to note some of these policies.

C.D Deshmukh was the first governor of Reserve Bank of India and served as the finance minister from 1960 to 1956. The first budget of the nation was presented by him. The first and the second five year plans which laid the ground for a stable economic base of the country were shaped by C.D Deshmukh. He also ensured social control of financial institutions for furthering their accountability following which he enacted the new Companies Act, nationalised the Imperial Bank of India and life Insurance companies. T.T Krishnamachari who held the port folio of finance minister from 1957 to 1958 observed the changed how the economic situation of the country has changed and therefore felt the need to levy fresh taxes thereby introducing major tax reforms. He set up the three major steel plants of the country. He also established the financial institutions of IDBI, ICICI and UTI. Once again resuming office from 1964 to 1966, T.T Krishnamachari stressed on the importance of providing social security to the citizens of this country. As such he introduced a new Family Pension Scheme in 1964 by virtue of which now the pension was to be expanded to the family members of government servants even after their death. He also was instrumental in introducing major schemes like the Rajasthan Canal Schemes, Dandakarnya and Damodar Valley Projects and the Neyvile Lignite Projects.

Finance Minister C Subramaniam holding office from 1975 to 1977 initiated the increase of revenue through excise. From 1985 to 1987, when V.P Singh was the Finance Minister, he made initiatives for tracking down those who evade tax. To this purpose he expanded the powers of the Enforcement Directorate of the Finance Ministry. Being in office during the Prime Ministership of Rajiv Gandhi, V.P

Singh oversaw the relaxation of the license raj which was instrumental in India until then. From 1987 to 1988, Rajiv Gandhi held the port folio of finance minister being the third Prime Minister to do so. It was during his regime that zero-based budgeting came into exercise. Zero-based budgeting ensures review, analysis and evolution of each budget request so that its inclusion or exclusion from the integrated whole budget is justified.

After independence for about three decades, India's economic policies were highly in favour of the public sector with stringent governmental controls over private sector investments. The Indian economy was a closed one where there was import licensing along with strict control on import of technology accompanied with high tariffs. The performance of the Indian economy under this system was average. However the efficiency of this system faced severe challenges in 1970s when the growth rate of the economy lowered. As a result of this the economy of the country began to be liberalized under the regimes of Indira Gandhi and Rajiv Gandhi.

However the major reform to this end took place in 1991 under the Prime Minister ship of Narasimha Rao and more importantly owing to the economic policies of the Finance Minister- Manmohan Singh. India was facing a severe balance of payment crisis. Its foreign exchange reserves went down to 1.1 billion dollars in 1991 which might have made India to default on its external debt payments. Under such circumstances, the economic policies of the finance ministry headed by Manmohan Singh initiating a stabilization programme that could entail the reduction of fiscal deficit and devaluation of the currency. It also initiated a package of structural reforms to increase the growth rate of the economy. To this end loans were negotiated with the International Monetary Fund (IMF), and structural assistance loans were attained from the World Bank and the Asian Development Bank. This finance ministry furthered a liberalization programme that ensured enhanced growth, role and performance of the private sector, foreign direct investment in the country and also was instrumental in red tape that was responsible for impeding business growth. Under the liberalization reforms was also included the appointment of a Committee on Tax Reforms headed by Raja Chelliah. This committee was to make recommendations bringing about change in both direct and indirect taxes. As such now a regime of low tax rates with a broader base was aimed for. There was reduction in indirect tax rates and in custom duties in order to attract completion to Indian industry from abroad. The reduction in import duties led gradually to a flexible exchange rate. The concept of service tax was also introduced by this finance ministry.

Many of the tax reforms which were initiated in 1991 were continued by Finance Minister P.Chidambaram who held office from 1996 to 1998. The tax reforms of 1991 were continued to be implemented and import duties were continued to be reduced and it was aimed that custom duties were to be brought down to East Asian levels by 2000. Insurance sectors were opened to the new private players and foreign insurance companies were to have 26% of foreign equity. A more rational approach was taken towards the reform of the public sector whereby the Disinvestment Commission was set up to recommend a transparent selling off of Public Sector Enterprises and their handover to private sectors.

When Yashwant Sinha headed the finance ministry from 1998 to 2002 he concentrated more on the rationalization of excise and reducing slabs from eleven to one. Even Jaswant Singh heading the finance ministry from 2002 to 2004 pushed for market-friendly reforms of the government.

P Chidambaram again headed the finance ministry from 2004 to 2014 under the regime of Manmohan Singh as the Prime Minister. However reforms during this time were more gradualist in nature. There was increased commitment towards fiscal consolidation as a result of which the fiscal deficits of the Central and the state governments declined between 2003-2004 and 2007-2008 being conducive to private investment. During this period, import duties continued to be reduced to 10% and foreign direct Investments were expanded. During this period, the process was started for the states to agree to an integrated goods and service tax.

Arun Jaitley on taking up the office of finance minister from 2014 also followed gradualist reforms in the economy. A fiscally prudent policy was continued with a commitment to reduce fiscal deficit to 3% of GDP by 2020-2021. Liberalizing policies were continued with respect to liberal industrial policy, openness to foreign trade and FDI. The finance ministry under Arun Jaitley could maintain its fiscal targets and prevented budgetary deficits to go out of control. Also finances were so managed that many social welfare commitments were fulfilled. A very important reform initiated during this period was the introduction of the Goods and Services Tax (GST) which was a reform in the domestic indirect taxes. Another reform brought about by this ministry was the Insolvency and Bankruptcy Code which aimed at speeding up the process of recovering debt from companies which defaulted at payments of debts.

## 8 Challenges of Finance Ministry

Montek Singh Ahluwalia, the former deputy Chairman of the Planning Commission of India pointed out the problems that the economic reforms in India have to adhere to. These have hold implications for the finance ministry to step in as this ministry is solely responsible for initiating such reforms. These stand out as major challenges before the finance ministry. When it comes to catering to social equity and justice in the Indian society which stands out to be a major aim of Indian fiscal policy, the progress has not been so impressive. There exist huge discrepancies in the provision of adequate formal employment, basic needs like education, health services, clean drinking water and sanitation to many sections of the population. There also exists inequality in income and wealth substantiated by data provided by “two India Human Development Surveys conducted jointly by the National Council of Applied Economic Research (NCAER) and the University of Maryland”. Along with these issues, there exists weak fiscal sustainability- “The combined fiscal deficit of the centre and the states is 6.7% of GDP which is twice that in other emerging market countries”. Infrastructure deficiency also exists as a major problem.

Although the government has introduced GST, it faces many criticisms like it has structural flaws, exclusion of many commodities from the purview of this tax and existence of too many rates. Again the demonetization policy initiated by the finance ministry under Arun Jaitley could not lead to an effective outcome. It was introduced on the presumption that this would uncover “hidden cash hoards from income that had escaped taxation, discourage counterfeiting and terrorist financing, reduce cash transactions in the economy and thus would discourage illegal and tax-avoiding activities”. However this policy could not yield the desired results.

In 2019, Nirmala Sitaraman became the Finance Minister amidst the situation of a difficult economic condition with increased unemployment and India losing its status as the fastest growing economy after China. The current Finance Minister has the huge task of reinvigorating India’s economy and mobilizing resources for funding the many social welfare programmes of the Modi government.

## 9 Conclusion

The above exhaustive discussion could fulfil the objectives of this unit. It elaborately explained the evolution of the finance ministry in India which is at the helm of economic affairs in the country. The finance ministry as it stands today has many departments which attend to various functions related to the economic affairs of the nation. The discussion above has elaborated on each of these departments. Many Finance Ministers of India over time have come up with policies which brought about significant reforms in the fiscal policy structure of the country. Finance ministry has been responsible for ensuring economic growth in the nation. However there are many challenges which the ministry faces.

## 10 Keywords-

Fiscal administration, Economic growth, Finance Commission, Goods and Services Tax (GST), Liberalization

## 11 Summary

- The finance ministry in India is responsible for the financial, fiscal and monetary administration of the nation.
- The finance department underwent many organizational redesigning over the years
- The Finance Ministry is divided into the department of Expenditure, department of Revenue and department of Economic Affairs.
- The Ministry of Finance also comprises two additional departments- the department of Financial Services and the department of Investment and Public Asset Management
- The Finance ministers of this country being at the helm of affairs of the ministry of finance have on many occasions undertaken steps that have led to achievements at the front of economic growth
- Major reforms to the Finance Ministry took place when India went forward with liberalization in 1990s
- The Finance Ministry faces several challenges. It has to attend to problems in the Indian economy like discrepancy in provision of basic needs to the public, provision of social justice and equity and proper implementation of fiscal policy reforms.

## 5.11Model questions

1. What is the role of the finance ministry in India? (6 marks)
2. How has the finance ministry in India evolved over time? (12 marks)
3. Explain the role of finance ministry in India before liberalization (12 marks)
4. Explain the role of finance ministry in India after liberalization (12 marks)
5. Discuss the contribution of finance Ministers in India (18 marks)
6. What are the achievements of the finance ministry in India? (18 marks)
7. What are the challenges faced by the finance ministry in India? (12 marks)

## 5.12 References and further readings-

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## Block III: Budget

## Unit-I

## STRUCTURE

3.1 Objectives

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3.4 Significance of Budgeting

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Performance Based Budgeting

Zero-Based Budgeting

Gender Based Budgeting

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### 3.1 Objective

The main objectives of this unit is to familiarise the students with:

The concepts of budgeting and budgetary control;

i. Provide a comprehensive and detailed analytic description of the budgetary system and process in India.
ii. To trace the origin of the budgetary system in India
iii. Classification of Expenditure and Institutions involved in budgetary process in India.

**3.2 Introduction** The word “budget” comes from an English word *budjet*, a concept used for the king's bag containing the money necessary for public expenditure [i]. The term is derived from a French word, ‘*Bougette*’, which means a leather bag or wallet from which the Chancellor of the Exchequer used to take out his papers about government’s financial schemes for the ensuing year for laying before the House of Commons and when he set off to place his financial plans before the House, he used to open his budget. The term was used in its present sense for the first time in1733 in the British parliament. Since then, the term has been used for a financial scheme or statement of annual income and expenditure of the government. The first traceable legal definition of the budget is contained in a French decree of 1862: ‘The budget is a document which forecasts and authorizes the annual receipts and expenditures of the State…’[ii] In our daily life, we use to prepare budgets for matching the expenses with income; and available funds can be invested in a profitable manner. Similarly in business, budgets are prepared on the basis of future estimated production and sales in order to find out the profit in a specified period. A budget is in the nature of an estimate and is a quantified plan for future activities to coordinate and control the use of resources for a specified period. Thus budget is a quantitative statement of management plans and policies for a given period and is used as a guide for the purpose of attaining the given objectives. It is also used as standard with which actual performance is measured. Budgets must be prepared with full knowledge and acceptance by the executives whose performance is to be measured against the budget. Different types of budgets are prepared for different purposes. Budgeting may be defined as the process of preparing plans for future activities of a business enterprise after considering and involving the objectives of the said organization. This also provides process/steps of collection and comparison of data, by which deviations from the plan, either favourable or adverse, can be measured. This analysis is helpful in performance analysis, cost estimation, minimizing wastage and better utilisation of resources of the organisation.

**III. Meaning and Concept:** In the discourse of Public Administration the term budget mainly refers to a financial document which is placed annually before the legislature of the state, by the executive. Since, today, government expenditure is aimed at a variety of objectives, including economic development, and social goals, or redistribution objectives. Hence, governments need sound fiscal policies, i.e., policies concerning government revenues, expenditures, and borrowing to achieve macroeconomic stability and other government objectives. The budget is thus the most potent instrument of the government in carrying out its policies. Infact in democratic societies, approval of the budget (the "power of the purse") is the main form of parliamentary control of the executive. Although, there exists no unanimity among writer regarding the definition of the term 'budget', but different scholars in Public Administration have defined differently by different scholars. Some scholars have used the term synonymously with 'programming' and some has considered it as 'art of management'.[iii] However most of the people agree that budget is the keystone of financial administration and the various operations in the field of public finance are correlated through the instrument of budget.

In the Indian Constitution the word 'budget' does not figure rather it is referred to as the 'Annual Financial Statement and as a Money Bill falls under Article 110 as it contains provisions dealing with all or any of the following matters, namely[iv]:

a) The imposition, abolition, remission, alteration or regulation of any tax;

b) The regulation of the borrowing of money or the giving of any guarantee by the Government of India, or the amendment of the law with respect to any financial obligations undertaken or to be undertaken by the Government of India;

c) The custody of the Consolidated Fund or the Contingency Fund of India, the payment of moneys into or the withdrawal of moneys from any such Fund;

d) The appropriation of moneys out of the Consolidated Fund of India;

e) The declaring of any expenditure to be expenditure charged on the Consolidated Fund of India or the increasing of the amount of any such expenditure;

f) The receipt of money on account of the Consolidated[v]

**IV. Significance of Budgeting**:

i. The Budgetary operations of the government have an important bearing on the functioning of the country's economy. The ideal of welfare state and economic planning have tremendously increased the magnitude of public spending, resulting in the emergence of the government as an important sector of economy.

ii. Government collects huge sums of money through taxation, borrowings and printing of additional currency. The manner of collection of these monetary funds and the pattern of their spending includes saving and investment levels, distribution of income and wealth, allocation of resources, and the consumption behaviour of the people.

iii. Modern economies specifically after the Covid-19 pandemic era are frequently at the beset with problems like inflation, excessive fluctuation in economic activities and deficit in the balance of payments. Budget thus acts as an important instrument to carry out corrective operations. Budget is not merely and exercise in matching expenditure to income but a powerful medium to realise objectives of public policy. Budget is a description of both the fiscal policies of the government and the financial plans corresponding to them.

iv. Budgets help government to chalk out planned appraisal of their earnings and proper means of controlling the channel of spending them. Absence of such exercise may lead to corruption, inefficiency and even bankruptcy of the government.. Hence Budget provides a platform for a planned earning and wise spending and promotes a stable government.[vi]

**V. Classification of Expenditure:** Government expenditure can be broadly classified into four categories:

*a. Functional Classification or Budget Classification:* In India, the classification of accounts was structured so as to correspond to the organisation in which the transaction occurred and within the organisation to the inputs on which expenditure was incurred. For example, construction of a hospital would be classified and displayed in accounts as "public' works expenditure" and not as expenditure on a programme like "Medical Relief" under social services. The classification indicated the nature of expenditure but not its purpose. It did not enable identification of expenditure with functions, programmes, activities and projects. It lacked management approach in accounting in as much as it did not provide the facility for monitoring and analysis of expenditure on functions, programmes, activities and projects. The Government of India introduced in April, 1974 a revised accounting structure, which attempts to serve the purposes of management as well as the requirement of financial control and accountability. Under this scheme, a five-tier classification has been adopted i.e. sectoral, major head, minor head, subhead, and detailed heads of account. Sectoral classification has grouped the functions of government into three sectors, namely, General Services, Social and Community services and Economic services. In the new scheme of accounts, a major head is assigned to each function and minor head is allotted to each programme. Under each minor head, there would be subheads assigned to activities/schemes/organisations covered by the programme. Under the new system, the object classification has been retained and placed at the last tier. It is meant to provide item-wise control over expenditure and ensure financial control and accountability. Functional classification established adequate links between budget and account heads and the plan heads of development. This has facilitated obtaining information of progressive expenditure on plan programmes and projects. The principle adopted in the new accounting classification is that all expenditures on a function, programme or activity should be recorded under the appropriate major, minor or subhead. Functional classification has provided the necessary facility for monitoring and analysis of expenditure on functions, programmes and activities to aid the management function.

*b. Economic Classification:* Economic classification refers to the resources allocated by government to various economic activities. It involves arranging the public expenditures and receipts by significant economic categories, distinguishing current expenditure from capital outlays, spending for goods and services from transfers to individuals and institutions, tax receipts by kind from other receipts and from borrowing and inter-governmental loans, grants etc. This classification brings out such important aggregates as public expenditure of the consumption kind, public investment and the draft of public authorities on public savings for financing the development oulays in the public sector. In short, this classification analyses the total governmental transactions and records government's influence on each sector of the economy.

*c. Cross Classification:* Cross classification provides the breakup of government expenditure not only-by economic categories but also by functional heads. For instance, expenditure on medical facilities (a functional head) is split between economic categories such as current expenditure, capital expenditure, and various types of transfers and loans. Conversely, cross classification shows how expenditure on a particular economic category, say capital formation, is divided according to different public activities like education, labour welfare, family planning etc. Under a scheme of cross classification, functional classification of expenditure can be analysed according to its economic character and economic classification of expenditure can be analysed according to the functions performed by it. The two types of classification therefore supplement each other and give a clear picture of the total transactions of government.

*d. Accounting Classification*: Accounting classification of government expenditure can be analysed under (i) Revenue and Capital (ii) Developmental and Non Developmental and (iii) Plan and Non-Plan. Each classification of expenditure serves one objective or other of the government. For instance, Revenue and Capital expenditure classification indicates how much government expenditure results in creation of assets in the economy and how much expenditure is unproductive. Again, developmental and non-developmental classification indicates how much government expenditure is spent on social and community services and economic services as against general services. Similarly, the Plan and Non-Plan expenditure classification helps the Planning Commission and Finance Commission in determining the pattern of central assistance on plan schemes to state governments, and union territories. Thus, each classification of government expenditure serves one objective or other in government.

**VI**. **Institutions in Budgetary process:** The budgetary process in India is indeed a difficult exercise. It involves a variety of institutions at various levels. The following are some of the major institutional bodies which helps in order to accomplish the task of budgeting in India.[vii]

a) **The Parliament:** Being the custodian of public money in the country, the Indian Parliament, especially the Lok-Sabha or the lower house of the Indian Parliament, is the supreme legislative body whose approval for the passage of budget is a must in the budgetary process. Under Article 112 of the Constitution, the President shall cause to be laid before both the Houses of Parliament the 'annual financial statement', which is the main budget document.

b) **Political Executive:** In India, the Ministry of Finance is the nodal agency and core unit of the Executive, entrusted with the task of managing the operational dynamics of the budget. The Ministry of Finance (MOF) is the nodal agency of the budgetary process.

Right from estimating the final figures of the revenues and expenditure of the government for presentation before the Parliament, the Ministry is vested with the task of ultimately ensuring that the finances of the country are managed with proper care.

c) **Audit Department**: Under the provisions of Article 148 of the Constitution of India, the office of Comptroller and Auditor General (CAG) conducts an audit on behalf of the Parliament to investigate and report on the trustworthiness, legality and efficiency of all the financial transactions carried out by government departments.

d) **Parliamentary Committees**: Finally, the Parliamentary Committees on Estimates, Public Accounts and Public Undertaking and around 24 departmental Standing Committees plays a significant role in the budgetary processes of the country. Important roles are assigned to these committees to exercise control over the finances of the government or its public undertakings and they are empowered to perform these tasks by parliament.[viii]

## VII. Budgetary Process in India:

Till 2016, the Budget was presented in the lower house of the Indian Parliament in two parts, namely, the Railway Budget pertaining to Railway Finance and the General Budget which gave an overall picture of the financial position of the Government of India, excluding the Railways. Since the year 2017-18, with the merger of the Railway Budget with the General Budget, a single document titled 'Union Budget' is now presented by the Minister of Finance. The Budget is presented to Lok Sabha on such day as the President may direct.[ix]

Usually, the formation of the budget estimates follows the cycle of the financial year, from 1st April to 31st March and each year on the first working day of February, it is presented by the Union Finance Minister in Parliament in the following format:

1. Actual figures of the previous three financial years;
2. The sanctioned budget estimates for the current financial year;
3. Revised estimates of the current financial year;
4. Proposed estimates for the next financial year, with explanatory notes for any increase or decrease in estimates; and
5. Actuals of the current financial year available at the time of preparation of the estimates and actuals for the corresponding period of the previous financial year.

The Annual Financial Statement or the main budget document is prepared by the Ministry of Finance shows the receipts and payments of the government under three parts in which government accounts are kept:

> *(i) Consolidated Fund-* All revenues received by government, loans raised by it, and also its receipts from recoveries of loans granted by it, form the Consolidated Fund. All expenditure of government is incurred from the Consolidated Fund and no amount can be withdrawn from the Fund without authorisation from Parliament. Occasions may arise when government may have to meet urgent unforeseen expenditure pending authorisation from Parliament.)
>
> *(ii) Contingency Fund-* The Contingency Fund is an imprest placed at the disposal of the President to incur such expenditure. Parliamentary approval for such expenditure and for withdrawal of an equivalent amount from the Consolidated Fund is subsequently obtained and the amount spent from Contingency Fund is subsequently recouped to the Fund. The corpus of the Fund authorised by the Parliament, at present, is Rs. 500 crore. Besides, these two funds under which government accounts are kept, there is Public Account in which moneys are received and disbursed.)
>
> (iii) Public Accounts- In respect of Public Account, government acts more as a banker, for transactions such as those relating to provident funds, small savings collections and other deposits. Parliamentary authorisation for such payments from the Public Account is, therefore, not required.)[x]

In a few cases, a part of the revenue of government is set apart in separate funds for expenditure on specific activities like road development, primary education, public health, etc. These amounts are withdrawn from the Consolidated Fund with the approval of Parliament and kept in the Public Account for expenditure on the specific items. The Budget has to distinguish expenditure on revenue account from other expenditure. Government Budget, therefore, comprises (i) Revenue budget, and (ii) Capital budget.

In India each year, the budget follows a cycle that includes: preparation, approval, implementation and auditing.[xi]

a. **. Preparation**:

- Firstly, due to a cumbersome procedures involved in the formation of the budget, the budgetary process in India informally begins around the month of September-

October of the preceding year. Initiating the process, the Ministry of Finance issues a circular to various ministries and departments inviting their estimates for the coming year.

- Secondly, On the basis of these circulars, various administrative agencies prepare their estimates, which are examined and scrutinised by Departmental Heads and then passed on to officers of the Finance Department/Ministry of Finance in November-December.
- Thirdly, by the 3rd week of January, the Ministry of Finance prepares the consolidated statement of revenues and expenditures, known as the 'Annual Financial Statement',
- Finally, the Union Budget of India (including the Rail Budget) is presented in the Indian Parliament.

b. **Approval**: The next step of budgetary process in India is getting the legislative approval for the Annual Financial Statement, once presented to the Parliament generally on the last working day of February.

- First, there is a general discussion on the broad economic and fiscal policies of the government as reflected in the budget and the Finance Minister's speech. This lasts about 20-25 hours.
- At the second stage, there is a detailed discussion on the 'demands for grants', usually in respect of specific ministries or departments. Demands for grants, are the executive's requisitions for sanction to spend, and only the lower house can have a say in the matter. While the legislature can object to a demand for grant, reject it or reduce it, it cannot increase the same. It may also be mentioned here that since no demand for a grant can be made except on the recommendations of the President or the Governor (in the case of State), private members cannot propose any fresh items of expenditure. Though the budget is presented before both Houses of Parliament, the demands for grants are submitted only to the lower house once submitted each demand for grant is voted separately.

At this stage members of parliament may move motions of various kinds. Generally these are-

*Policy cuts motions*: seeks to reduce the demand to rupee one and is indicative of the disapproval of general or specific policy underlying the service to which the demand pertains.

*Economy cuts motion*: where the motion is to reduce the proposed expenditure by a specified amount.

*Token cuts motions*: where in a demand is moved to reduce it by a nominal amount say Rs. 100 and may be used as an occasion to ventilate a specific grievance.

Since it is never possible to accommodate a detailed discussion on each demand for grant separately, the demands that cannot be so discussed are clubbed together and put to the vote of the Parliament at the end of the period allotted for discussion.

- Thirdly: even after the demands for grants have been voted by the Parliament, the executive cannot draw the money and spend it. According to the Constitutional provisions, after the demands for grants are voted by the Lok Sabha, Parliament's approval to the withdrawal from the Consolidated Fund of the amount is sought through the Appropriation Bill. The Appropriation Bill after it receives the assent of the President becomes the Appropriation Act. Thus, without the enactment of an Appropriation Act, no amount can be withdrawn from the Consolidated Fund. Since the financial year of the government is from 1st April to 31st March, it follows that no expenditure can be incurred by the government after 31st March unless the Appropriation Act has been passed by the close of the financial year. This is generally not possible as the process of discussion of the budget usually goes on up to the end of April or the first week of May. Thus, in order to enable the government to carry on its normal activities from 1st April till such time as the Appropriation Bill is enacted, a Vote on Account is obtained from Parliament through an Appropriation (Vote on Account) Bill.

**c. Execution**: The execution of the budget is the responsibility of the executive government. The procedures for execution of the budget depend on the distribution and delegation of powers to the various operating levels. As soon as the Appropriation Act is passed, the Ministry of Finance advises spending Ministries/ Departments about their respective allocation of funds. The controlling officers in each ministry/department then allocate and advise the various disbursing officers. The expenditure is monitored to ensure that the amounts placed at the disposal of the spending authorities are not exceeded without additional funds being obtained in time. The Department of Revenue in the Ministry of Finance is in overall control and supervision over the machinery charged with the collection of direct and indirect taxes. Such control is exercised through the Central Board of Direct Taxes and the Central Board of Indirect Taxes. These Boards exercise supervision and control over the various operational levels which implement different taxation laws. The Reserve Bank of India is the central banker of the government. The nationalized banks and the network of treasuries are also performing the service of collection (receipts) and disbursement of funds.

**d. Auditing:** The executive spends public funds as authorized by the legislature. In order to ensure accountability of the executive to the legislature, public expenditure has to be audited by an independent agency. The Constitution provides for the position of the Comptroller and Auditor General of India to perform this function. It is his/ her duty to ensure that the funds allocated to various agencies of the government have been made available in accordance with law; that the expenditure incurred has the sanction of the competent authority; that rules, orders & procedures governing such expenditure have been duly observed; that value for money spent has been obtained and that records of all such transactions are maintained, compiled and submitted to the competent authority. This is the last stage in completing the budgetary cycle.

## IX. Types of Budgets – Performance, Zero-Based and Gender Budgeting:

### Performance Based Budgeting (PPB)

Performance Based Budgeting (PPB) was to overcome most of the shortcomings of the traditional line-item budget. Performance budgeting for the first time originated and development in the United States of America, during 1950's. Followed by this the-then newly independent developing countries of the world in Asia, Africa and Latin America, who were committed to bring in about rapid socio-economic progress incorporated this principle of PPB, partially if not fully in their financial administration. In India the proposal for PBB started originating in the mid 1950's. The estimates Committee discussed budgetary reforms in its twentieth report and recommended the adoption of performance budgeting in India. It retreated this recommendation again in its report in 1960. Following the recommendation of the Administrative Reforms Commission in 1968, four central ministries adopted the model of PBB in drafting their financial statement. In 1977-78, about thirty-two developmental departments under the Central Government switched to this new model of budgeting and since then eventually, many state governments introduced the model in drafting their financial statements.[xii]

## Background:

After the Second World War the newly independent countries of Asia, Africa and Latin America were engrossed in rapid socio-economic  progress and development of their people and thus in course of time the bureaucracy became the most important instrument for the implementation of public policy. Developmental goals like improving the level of societal services, health and education, building roads and facilitating communication and electricity or raising production I agriculture and industry made them realise the essentiality of incurring governmental expenditure. In the change-oriented milieu of development administration, with a vision for a social welfare centric state focused on increased governmental spending, some of these newly independent countries adopted the new tool of Performance Based Budgeting (PPB) system which back at that point of time was newly introduced at the United States of America. Primarily the main onus of this new reform in the financial administration was to suit the need for massive public investment and expenditure which was somehow not possible in the traditional accountability based line-item based budgeting. Elaborating the rational for such reform MJK Thavraj in the book, Financial Administration of India writes- *The need for result-oriented budgeting is more keenly felt in all the developing countries where investable resources are few, the backlog in development is considerable, entrepreneurship is scarce and consequently the role of the government is all-pervading, embracing a wide variety of enterprises ranging from the simplest of consumer goods to the most complex capital goods industries and infrastructural facilities. Planning and budgeting are therefore extremely important to ensure economy, efficiency and effectiveness in the use of resources…. measurement of performance is thus an essential aspect of a result oriented budgeting.*[xiii]

## Features of Performance Based Budgeting:

- As a financial document it seeks the implementation and control of governmental programme through budget allocation. This is done by presenting the government operation in terms of programmes, activities and functions.
- Through such a functional classification of governmental financial operations, public policies are sought to be identifies in the annual budget in concrete physical terms so

that a direct interaction between inputs and outputs could be identified and state performance reviewed through clearly identifiable cost overheads.

- In traditional budgeting the object of government expenditure, purpose of the different proposed outlays, or linkages between cost and performance cannot be clearly identified or accessed. In performance based budgeting, the focus is on the end rather than the means.
- The main purpose of this budgeting tool is to clearly define the objects of governmental spending the work to be performed and an estimated cost of the performance.
- The concept of performance budgeting which is also called a programme budget, sets in advance the targets and the authorisation against which the performance of the governmental departments can be accessed periodically.
- It serves as a basis for efficiency and work measurement qualitatively and quantitatively. The performance of the past year serves as an evaluation sheet for the next years' budgetary targets and estimates.[xiv]

**The 5 elements of Performance Based Budgeting:**

- Programming or the sub-division of the governmental budget for information purpose into programmes and activities representing identifiable unites with similar aims or operations.
- Identifying the operational aims of each programme and activity for the budget year.
- Budgeting and accounting for each programme so that the separate costs and revenues of each programme and activity are shown.
- Measuring the outputs and performance of activities so that these can be related to their costs and to operational aims; and finally
- Using the resultant date to establish standards and norms so that costs and performance can be evaluated and government resources used more efficiently.

**Principles of PBB:**

- Firstly, evolving a meaningful classification structure in terms of programmes, projects and activities under each function entrusted to an organisation in order to show precisely its objectives, the work done and the organisational responsibilities.

- Secondly, bringing the system of accounts, reporting and the prevailing financial management practices in general into accord with the new classification and requirements of performance budgeting

- Lastly, establishing suitable work units for physical measurement of work done, or services rendered under each programme and activity and developing suitable norms, standards and other performance indicators for appraisal of performance.[xv]

In a nutshell PBB attempts to integrate the planning, budgeting, costing, reporting and controlling the system of the organisation.

**Stages of PBB:**

1. **Categorisation:** The first stage in Performance based budgeting starts with compiling a functional classification of all governmental activities in functional-programme-activities and projects. Usually the classification is done under the following pattern:

| | |
|---|---|
| Functions | The first step is broad categorisation of the all activities under departmental heads such as agriculture, education, industry and health. |
| Divisions | Each functional categories are then further sub-divided into *programmes*, for instance heath may be sub-divided into primary health, child health and public health |
| Activities | Once the programmes are outlines, each programmes are deconstructed into *activities*. Activities constitutes the collection of similar types of work in a programme, the purpose of which is to contribute to the achievement of the broader programmes. Ex- Training of Rural Health Workers in the broader Public Health Programme of a State. |
| Projects | Lastly, each activities are further and finally sub classified into Projects on the other hand entails any activity that requires capital investment, such as building hospital and clinics. |

2. **Fiscal management and cost reporting:** Secondly stage of PPB is evolving a system, of fiscal management and cost reporting which may be in accordance with the objectives of a programme budget. Basically in this step the financial requirement data is placed primarily under three main broad categories-

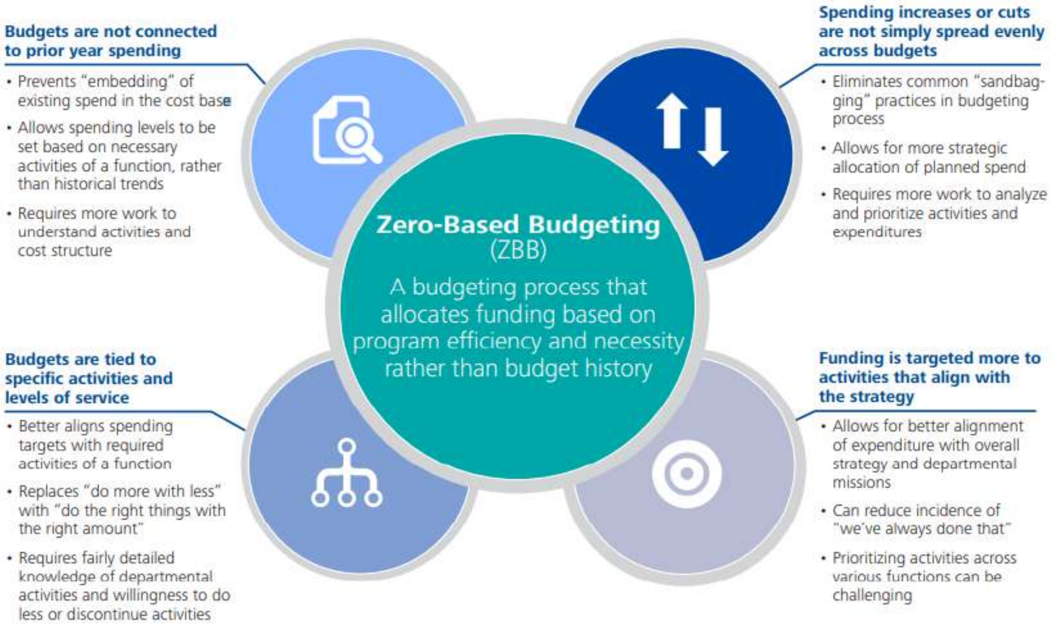
a. Programme and activity classification
b. Object wise classification such as establishment charges, travel, grant-in-aid etc.
c. Sources of financing indicating the demand numbers and major heads under which these outlays are included.

3. **Accessing the performance:** Thirdly in a PPB developing an accurate statistical weights and measures of accessing government performance in terms of adequacy and unit cost.
4. **Evaluation or Feedback:** Lastly, establishing in the budgetary process, an objective system of performance evaluation to provide periodic feedback to executors of public policies.[xvi]

## Zero Based Budgeting (ZBB)

### Evolution of ZBB:

Peter Phyyh, an accountant manager in a Texas-based firm in United States created this method of Zero Based Budgeting (ZBB) in the year 1970. Though the private sector uses ZBB, first rose to prominence in government during the 1970s financial crisis. Faced with mounting public pressure, U.S. President Jimmy Carter promised to balance the federal budget and reform the federal budgeting system using ZBB, which he had used while governor of Georgia. Though initially well received, ZBB proved not only complicated and time consuming, but also ineffectual, as it was Congress and the executive branch that were ultimately responsible for deciding whether to keep or eliminate a program. Additionally, the president’s budget office used a variant of ZBB as agencies were asked to rank their programs within funding limits. This forced the agencies to assign priorities and identify possible reductions. President Reagan abandoned the system after his election in 1980, and since then, the use of ZBB use in both the public and private sectors has been limited, primarily due to its high level of complexity and large requisite investment that can hinder its execution.[xvii]



Budgets are not connected to prior year spending

- Prevents "embedding" of existing spend in the cost base
- Allows spending levels to be set based on necessary activities of a function, rather than historical trends
- Requires more work to understand activities and cost structure

Spending increases or cuts are not simply spread evenly across budgets

- Eliminates common "sandbagging" practices in budgeting process
- Allows for more strategic allocation of planned spend
- Requires more work to analyze and prioritize activities and expenditures

Zero-Based Budgeting (ZBB)

A budgeting process that allocates funding based on program efficiency and necessity rather than budget history

Budgets are tied to specific activities and levels of service

- Better aligns spending targets with required activities of a function
- Replaces "do more with less" with "do the right things with the right amount"
- Requires fairly detailed knowledge of departmental activities and willingness to do less or discontinue activities

Funding is targeted more to activities that align with the strategy

- Allows for better alignment of expenditure with overall strategy and departmental missions
- Can reduce incidence of "we've always done that"
- Prioritizing activities across various functions can be challenging

*Image: Zero-Based Budgeting: Zero or Hero? Deloitte Analysis.*

### Essential principles of ZBB:

There are 3 essential principles of ZBB which primarily distinguishes it from the conventional or traditional budgeting:

- *Firstly*, under the conventional system, departments (called budget units) prepare and submit budgets which group many important activities under one head, making it difficult to scrutinise each activity closely. As against this aggressive approach, ZBB requires budget units which are small enough to allow close examination of their programmes. ZBB puts under magnifying glass the nature of activity of each budgetary units. For Example, in the case of education department, a separate budget need to be prepared for elementary education instead of for the whole department. Once the budget unit's activity is identified, the ZBB procedure asks: what is the activity were not funded at all? Are there other ways to perform the activity and meet the unit's objectives? The primary onus of explanation lies squarely on the departmental heads who are responsible for the activity and for preparing its budget. For instance, the Education Department of West Bengal Government may be asked what if dengue erdication programmes were not funded. A possible answer to answer from the government of west Bengal can be: 'mosquitos would thrive and this could raise the number of dengue cases.' However under the ZBB model a more definitive and qualitative answers are sought such as the estimated increase in the incidence of dengue, likely number of patients lost, increase in public and private medical bills and possibilities of fatalities. In essence, it becomes an exercise in social cost-benefit analysis involving strenuous exercise at each departmental level.

- *Secondly,* ZBB assumes that even if an activity needs to be finances it can be financed at a lower-than-current level. In other words, economy in public expenditure on public activities is at the heart of ZBB's second essential rule. It requires evaluation and review of all programmes and activities, current as well as new, and believes that those who are in-charge of public spending have the capacity to cut down expenditure without adversely affecting the current level of public services.
- *Third and finally*, ZBB requires priority-ranking competing services of a budgetary unit. Tis ranking is done by listing all events of a decision package in order to decreasing benefits to the community. High-priority services are ranked at the top followed by low-priority services until all are ranked. The list so prepared is used to fund services in order of priority until available resources are exhausted. Many of the services at the end of the list may just be eliminated for want of funds.

In brief, the three essential principles of ZBB are the following:

a. Should we spend?
b. How much should we spend?
c. Where should we spend?

**Key features of ZBB**:

In his book 'Zero Based Budgeting: A Practical Management Tool for Evaluating Expenses', Peter Phyyh argues that the aim of Zero Based Budgeting is to facilitate the introduction of top level strategic issue in budgeting process.

1. As a budgetary tool ZBB, allocates funding based on program efficiency and necessity rather than budget history, and suggests that in order to allocate resources more efficiently, one should tie expenditures with results. Which meant that rather than starting from a true zero base as ZBB would suggest, the agencies would start from a "priority base".

2. As opposed to traditional budgeting, no item is automatically included in the next budget, rather in a ZBB, budgeters review every program and expenditure at the

beginning of each budget cycle and must justify each line item in order to receive funding.

3. Budgeters can apply ZBB to any type of cost: capital expenditures; operating expenses; sales, general, and administrative costs; marketing costs; variable distribution; or cost of goods sold. When successful, ZBB produces radical savings and liberates organizations from entrenched departments and methodologies. When unsuccessful, the costs to an organization can be considerable.

4. Under the ZBB, each item of expenditure is challenged for its very existence in every budget cycle and no base or minimum expenditure level is presumed for an activity.

5. ZBB, means that past is cut-off, the present regraded as a clean slate and all departments have to start from a scratch, hence the name Zero Based Budgeting.

6. It is also called the sunset budgeting meaning that the sun would set on each government activity after a specified period. Before the sunset date, each department would be required to present a ZB, indicating the achievements of its activities and what would result if the activities were not renewed.[xviii]

### Advantages of ZBB

• Resulting budget is well justified and aligned to strategy

• Catalyzes broader collaboration across the organization

• Supports cost reduction by avoiding automatic budget increases, often resulting in savings

• Improves operational efficiency by rigorous challenging of assumptions[xix]

### Disadvantages of ZBB:

• Costly, complex, and time consuming as budget is rebuilt from scratch annually, whereas simpler and faster traditional budgeting requires justification only for incremental changes

• May be cost-prohibitive for organizations with limited funding

• Risky when potential savings are uncertain

• Execution challenged by budget cycle timing constraints

- Typically requires specialized training or personnel to accomplish, and requires more resources in general
- May be disruptive to the organization's operations
- Could harm organizational culture or brand

**Gender Budgeting:**

I. **Origin**: World-wide, there is a growing recognition of the need for a fundamental rethinking of the macro-policy framework for a gender perspective. The entire idea of this type of budgeting can be traced firstly, from the United Nations conference of the 1990s affirmed a global consensus on the need for a new approach to macro policy in the sustainable human development paradigm, which is based on the cornerstones of gender equality, poverty eradication, environment regeneration and democratic governance. Finally it was the United Nations Fourth World Conference on Women held in 1995 at Beijing contributed to the emergence of an international consensus in integrating a gender perspective in all polices and their budgetary dimension. Since then countries while formulating their budgetary policy have always given due consideration and importance to the question of gender question in their fiscal policy.

II. **Meaning**: Gender budgeting refers to presentation of budgetary data in a manner such that the gender sensitivities of budgetary allocations are clearly highlighted. Gender Budgeting includes carrying out an impact analysis of government programmes and its budgetary allocations on the overall socio-economic status of women in the country. It is necessary to realise that women are equal players in the economy-directly as workers and indirectly as members of care economy. Thus Gender budgeting analysis helps in the streamlining of the gender equality ion the society. This type of budgeting lays stress on the philosophy of *reprioritising* rather than an increase in overall public expenditure and in particular, the *reorientation* of programmes within sectors rather than changes in the overall amounts allocated to particular sectors. Moreover, one of the key thrusts of a gender-sensitive budget is to ensure a greater visibility of the unpaid *care economy.* In other words, a gender responsive a budgeting applies a gender lenses to budgetary resources allocation, providing more visibility to women's unpaid work.[xx]

III. **Components of Gender Budgeting**: Generally, a gender budgeting involves the following four components:

**a.** Budgetary allocation of resources to various head

**b.** Actual government outlays on various head

**c.** An accounting of how resources are utilised for a particular purpose

**d.** Evaluation of the effectiveness of the resources utilised in delivering the intend result.

**IV.** **Indian Experience:**A special reference, in the year 2000-2001 by Yashwant Sinha, the- the Union Minister of India in his budget speech for the first time gave a justification pertaining to the access of women to national resources, and this marked the dawn of gender-sensitive budgeting in India. Following this in 2004-2005, the Mistry of Women and Child Development (MWCD), adopted the mission statement of Budgeting for Gender Equality. Since then, several initiatives have been taken by the MWCD to operationalise gender budgeting in India.

The following are some of the key corner stone of gender based budgeting in India-

a. Quantification of allocation of resources for women in Union/ State/ Local Budgets.
b. Gender audit of policies of government
c. Impact assessment of various schemes
d. Analysing programmes and strategies.
e. Institutionalising generation and collection of gender disaggregated data.
f. Consultations and capacity building.
g. Gender based profiling of public expenditure
h. Gender based spatial manning and participative budgeting.

### 3.13 Summary

A budget is in the nature thus is an estimate and is quantified plan for future activities to coordinate and control the use of resources for a specified period. Budget is used as a standard with which actual performance is measured. Budgeting is a process which includes both budget and budgetary control. Budget is a planning function and budgetary control is a system and technique which uses budgets as a means of controlling all aspects of the business and is designed to assist management in the measurement of actual performance, in the analysis of deviations from the budgeted targets and to evaluate performance and efficiency of the operations. A good budgeting system requires good organisational system with the lines of authority and responsibility clearly mentioned. The important essentials required for the establishment of a sound system of budgeting includes budget centres, budget committee, budget officer, budget manual, budget period, budget key factor, forecasting, determining level of activity and preparation of budget. Budget may be classified on the basis of time, function and flexibility. On the basis of time, budget may be classified as long term budget, short-term budget and current budget.

### 3.14 Glossary / Key Words

- Budget : A comprehensive and coordinated plan, expressed in financial terms, for the operations and resources of an enterprise for some specific period in the future.
- Budgeting : The process of preparing plans for future activities of a business enterprise for attaining the objectives of an organisation.
- Budgetory Control : The establishment of budgets relating to the responsibilities of executives to the requirement of a policy and the continuous comparison of actual with budgeted results either to secure by individual action the objectives of that policy or to provide a basis for its revision. Budget
- Centres : Different sections of an undertaking or an organisation, where budgetory control measures to be applied and for the purpose, separate budgets are to be prepared.
- Budget Committee : A group of representatives of various functions in an organisation
- Budget Officer : A person who links up or coordinates the various functions, to bring them together and coordinate their efforts in the matter of preparation of target figures.
- Budget Manual : A document which sets out standing instructions, the responsibility of the persons engaged in, and the procedures, forms and records relating to the preparation and use of budgets.
- Budget Period : The period for which forecasts can reasonably be made and budgets can be formulated.
- Budget Key Factor : The factor which at a particular time or over a period will limit the activities of an undertaking.
- Forecasting : A statement of events likely to occur
- Fixed Budget : A budget prepared on the basis of a standard or a fixed level of activity
- Flexible Budget : A budget designed in a manner so as to give the budgeted cost at any level of activity.
- Master Budget : A summary budget incorporating all functional budgets which is finally approved, adopted and employed.

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## BLOCK IV

## UNIT I

## Control Over Finance

### LEGISLATIVE

STRUCTURE

- 1.01 Learning Objective
- 1.02 Introduction
- 1.03 Historical Perspective of Legislative Control over Finance
- 1.04 Nature of Parliamentary Control over Finance
- 1.05 General Principles Followed by the Constitution to ensure Control Finance Over Finance
- 1.06 Legislative Control over the Taxation policy
- 1.07 How Parliament Puts its Control Over Executive
- 1.08 Conclusion
- 1.09 Summary
- 1.10 Glossary or Key Words
- 1.11 Model Questions
- 1.12 Reference

- **1.01 Learning Objectives:**

Financial administration is an important aspect of public Administration and is concerned with almost all aspects of the financial management of a Government. Especially the importance of this aspect has recently been enhanced because of the tremendous increase in the amount of money expended on government services. This changing aspect has naturally affected the extension of functions of the Legislature. Thus the objectives of this unit are to discuss the nature and importance of Parliamentary control over finance.

- **1.02 Introduction**

The necessity of understanding the role of Finance in the process of functioning of the Legislature of the country may be understood by the statements made on its importance. L.D.White said, "Every administrative act has its financial implication, " which is subserved by the Government through its Legislation, especially in a Democratic form of structure. Financial administration is at the core of modern government. The founders of the Indian Constitution very emphatically constructed the parliamentary form of government based on universal adult suffrage and direct election after a particular period. At the same time, the founders also suggested that the upper house will be formed through an indirect election. Framers of the Indian Constitution described India as the Sovereign Democratic Republic with a federal structure and a Parliamentary form of government.

The parliament as the base of Indian democracy exercise its control over the framing and implementing laws on all necessary and nationally important matters. In this process, the elected representative in the Parliament exercises its controlling power in achieving the goal of government. In the process of parliamentary governance, the representatives issue a mandate to the executive. This function of the elected members of the parliament makes them responsible to the people. This also enables the representative to prove their accountability to the electorate. The Constitution has vested the Parliament with many instruments through which it can enforce accountability on the government.

- **1.03 Historical Perspective of Legislative Control over Finance.**

The concept of budget and legislative control over the Finances through controlling the Budget began to develop in the late middle ages when the revenue was collected from the domain of the King or Zaminder of the property. From that incident, a new legacy started to generate, where the budget became the statement of revenue and expenditure. During war or other exigencies, when the King or ruler required a lot of money for running the affairs in the interest of the domain or the state, he had to consult the nobility to know their views on the imposition of the new tax. The consultation was mainly made to understand the social effect of the imposition of extra tax. Only after the Glorious Revolution in 1688, there was a public principle that *"no revenue without representation"* got established. But during that period the control over expenditure had still not acquired the conventions of legislative approval. Historically the system of legislative control over Public Finance first arose in England and it was more a growth than a creation. The first step that was taken in this direction was during the reign of King John. The reign of King John established the convention of controlling the receipt and revenues. But no step was then taken to put control over the expenditure. Later the Stuart autocracy first took the initiative to make the Parliament more exacting in maintaining financial discipline. From this time the parliament started to make the political claim to put its control over the expenditure as well. But this did not come about suddenly. Even this also not came through any concerted plan or design. This development was again made gradually. The initiation of this development began in 1787. Gradually the process of audit and accounting started its journey to establish and authenticate the authority of legislature over the expenditure. So this should be remembered that the audit system under the Exchequer and Audit Department Act 1866, and the constitution of a Standing Committee of Public Accounts in the House of Commons in 1866 were significant historical development in the arena of Legislative Control. Through this path finally, the modern system of Audit and Reporting was built. With this, a new era of a new system of legislative control began and in India after her independence, the framers of the Constitution incorporated the system of sanctioning money and checking expenditures in a project. So legislative control on finance was followed from the prevailing British system of Parliamentary democracy.

- **1.04 Nature of Parliamentary Control over Finance.**

The aim and focus of the Parliamentary control over the National finance are used to ensure proper and plan-oriented execution of the allotment made by the Budget. The financial control of Parliament has practically ensured the proper execution of the Budget. The changing role of governments globally brings out their increasing responsibility for various activities, resulting in increasing expenditure and simultaneously an effective control of Parliament over the executive, the main spender of the budgetary allotment. This control also assured the accountability of the executive in implementing the development projects sanctioned by the parliament through the budget. The proposal of approving the grant in the budget is placed in the parliament, and the parliament/ Legislature passed it based on the support of the majority members, after a long discussion on the submitted report of the concerned committee of the parliament. This is one of the major ways of controlling the national purse, where the elected members in the parliament took the most vital role. For the proper functioning of the norms of approval, the parliament essentially required a proper monitoring mechanism. Because the natural tendency of any government is to place their require of public funds for appropriation and allocation to carry out the work. To achieve this goal properly there is reliable and accessible information which can indicate the actual responsibility of the working agencies.ParParliamenthould rerememberhat that any lapses in financial control have serious repercussions on the soundness of the public delivery system and develop it in sectors. Besides, this there are alsoimportantprtant procedural s parliamentlimtheh could also be used to control seeing of Budget expenditures too. such procedures through and at a regular periodic interval review of the expenditure. This will ring out the fact whether the allotted money and fund have been properly utilised for which it was allocated by Parliament. In this process, the following principles are followed:-

- The executive, acting through the elected Minister is not given the authority to raise money, through imposing tax or borrowing from the market or other sources, for any project or developmental work. The parliament is the final and last authority to emanate and consider any proposal for additional allotment.
- Loksabha is vested with the power to control the money bill exclusively. Such a Bill proposal must originate in the Lok Sabha which enjoys exclusive power on the Money bill. It also enjoys raising the exchequer by imposing a tax or by taking loans from the market. Being the sole authority for raising funds the LokSabha is also authorised to check the expenditure through its different Financial Committees.
- The demand for a grant must come from the government. Neither Lok Sabha nor a state assembly may vote on a grant except on a demand for grant government.
- The proposal of imposing a new tax or for any market loan must come from the Government, private members are not allowed to raise the such issue in the Lok Sabha.

This may raise a question on the role of private members in the Parliament. The parliament in its capacity can at any time raise questions using the norms of putting such an instrument of control. These instruments of control to the hands of private members are, ‘question hour’, ‘debate’ ‘discussion’ ‘passing various relevant motions’ etc. apart from this, the private members may place the proposal of sending any debatable issue to the parliamentary committees which too play an important role in exercising control and supervision.

There is also some provision for using the Consolidated fund by the Lok Sabha.

- **1.05 General Principles Followed by the Constitution to ensure Control Finance Over Finance.**

In any Country, the effectiveness of parliamentary democracy greatly depends on the control over the exchequer. The national exchequer is the bloodstream of all administrations. It is the major factor in the determination of Government policies. The sign of good governance generally establishes through its sound financial system. Considering the importance of finance and financial control, our founding fathers of the Constitution aptly vested the exclusive power and privileges to control the nation’s power to the Lok Shabha’.

Thus Indian system of legislative control over finance and financial policy greatly rests upon the rules of the Constitution and on the rules of the Lok-Sabha. The prime fundamental principle of Indian financial legislation is that no taxes may be laid without sanctioning the Parliament. Similarly, without the proper legislative approval public money cannot be spent. Both are controlled by the Legislature with its authority. The approval of yearly expenditure from the Government exchequer is given by the Parliament. This power of the legislature is its statutory power.

There is also a second principle. The president shall, in respect of every financial year, cause to be laid before both Houses of Parliament the Annual Financial Statement embodying the estimated revenues and expenditure for the coming year (Article 112, 113, 265) This especially indicates that the Parliament or Legislature shall generally not consider any proposal for expenditure of money and any proposal for raising revenues unless it is not recommended by the President. As per norms determined by the Constitution, the Cabinet, consisting of the elected members of the Parliament works on behalf of the President and under the leadership of the Prime Minister. Government is the spender. Being a spender the members of the Legislature decide not only the plan proposal submitted to the house, viewing the purpose and utility of the project it also sanctioning the amount for materializing the project. So Legislature decides the necessity of funds for the completion of the project. Along with that it also approved the excess amount over the grant if it feels it necessary.

So to summarise the issue, it can be said that the main thrust of legislative control over finance is exercised in two stages. The first is at the time of policy-making and the second is while reviewing the implementation of the policy. The legislature has control of the purse and determines the quantum of resources and the manner of raising and spending the same. The initial control is exercised at the time of the presentation of the annual budget or the annual financial statement, showing the estimated receipts and proposed expenditure of the Government, for the financial year. The second stage of control viz. the control over the implementation of the policies is to review whether the sums of money voted by the legislature have been utilized for the purposes for which and in the manner in which the legislature wanted them to be utilized.

Our forefathers of the Constitution made some definite provisions for enforcing the control.

- As per Article 107 (i) subject to the provision of Articles 109 and 117 concerning Money Bills and other financial bills, a bill may originate in either House of Parliament and subject to the provision of Articles 108 and 109 a Bill shall not be deemed to have been passed by the House of Parliament unless it has been agreed to by both the Houses either without amendment or with such amendments only such amendment are agreed to by both the House.
- Article 109 (I) provides that Money Bill shall not be introduced in the Upper House of the Parliament.
- As per Article 109(2), after a Money Bill has been passed by the House of the People, it shall be transmitted to the Upper House for its recommendations and the Upper House shall within a period of fourteen days from the date of receipt of the Bill return the Bill to the House of the People with its recommendations.
- The House of the People may thereupon either accept or reject all or any of the recommendations of the Upper House.
- As per 109(3), if the House of People accepts any of the recommendations made by the Upper House, the Money Bill shall be

deemed to have been passed by both Houses with the amendments recommended by the Upper House and accepted by the House of people.

- Article 112(1) provides that the President shall in respect of every financial year cause to laid before both the Houses of the parliament, a statement of the estimated receipt and expenditure of the government of India for the year. Such a statement is called an "Annual Financial Statement".

There is also some clear provision on the use of Consolidated Funds by the House of People. As per Article 113(1), the expenditure charged upon the Consolidated Fund of the Government shall not be submitted to the vote of Parliament. But Article 114(1) also provides that as soon as the grants under Article 113 have been made by the House of People, there shall be introduced a Bill to provide for the appropriation out of the Consolidated Fund of India of all money required to meet. Thus:

- The expenditure charged on the Consolidated Fund should never exceed the amount shown in the statement
- This Fund can be used to i) make the estimated expenditure; ii) use the Fund to meet any unexpected demand upon the resources of India; iii) make an exceptional grant which forms no part of the current services of any financial year.

- **1.06 Legislative Control over the Taxation policy.**

Control over finance through the yearly Budget can never be completed unless and until a provision has been made for accumulating the financial resources required to maintain the Budget programme in the country. For this purpose, a finance bill is placed before the parliament. Our previous chapter discussed in detail the process of placing of Money Bill and the different phases it passed before final approval. There are some differences between 'Money Bill' and 'Budget'.

- Money Bill deals exclusively with taxation, borrowing or expenditure. Whereas Finance Bill has broader coverage in that it deals with other matters as well
- A  Money Bill must be certified by the Speaker of the Lok Sabha.

- A Money Bill must be returned by the Upper House to the Lok Sabha within 14 days of its receipt with its recommendations, if any, which the Lok Sabha is not bound to accept
- Disagreement over a Finance Bill, however, is resolved at a joint sitting by a majority of the total members present and voting

A Finance Bill embodies the taxation or revenue proposal for the financial year. This practice is quite in consonance with the well-known principles of democracy that, “no tax shall be levied or collected except by authority of law as embodied in Article 265 of our Constitution. So while the passage of the Appropriation Bill authorises the Government to appropriate money from the Consolidated Fund, the passes of the Finance Bill authorises it to collect taxes”.

The function of the Legislature to enforce control over Finance starts with the question placed by the members of the Parliament, especially to members of the Government. This controlling weapon is used against the Executive by the Legislature. The question may be raised:-

- Misuse of Funds: The opposition often asks the members of the executive regarding aberrations in public expenditure. The Executive then has to clarify the doubts, perhaps stemming from any miscommunication or misinformation, raised by the opposition. The Executive is politically bound to clear the doubts raised by the opposition.
- Members of the parliament, especially the Opposition party use the legislative platform as an ‘interactive dias” to ventilate their grievance s.It is said that the asking question is an “inherenrightts of members of the Parliament”.Thee hour of question may be termed as the hour of trial of executhe tive. Because every mmember/ especially Ministers are answerable for the acts of their department.
- In Indian Parliamentary Democracy Parliament is considered as the place of interaction among the members.

Generally, four types of questions are seen to be placed in the Parliament. These are;

- Starred Question. When a member desires to get a reply to any question, he generally marked the question with an asterisk. This question belongs to the category of Starred questionsn.
- Unstarred Question. Sometimes members do demand an immediate verbal reply from the concerned members of the executive.

There are some question which aims to discuss on the financial control of the legislature and its effectiveness. These are:

1. Short Notice Questions: These questions are generally made on any urgent matter. The such important questions can be asked on shorter notice than ordinary questions.
2. **.** Private Member Questions**:** A question may be addressed to a private member provided the subject matter of the question relates to some bill, resolutionor otherr matter connected with the business of the house for which that member is responsible

- **1.07 How Parliament Puts its ControlOver Executive with the help of Committees.**

Parliament has some useful instruments in its control which help it to substantiate control over the Executive. Among that most important instrument is **Budgetary Control**. As per our Constitution no money can be spent by the executive without sanction of the majority members of the Parliament. The Executive in each year placed the budget proposal to the house. The members of the house made an extensive debate in the Parliament on the proposal, which ultimate put to the vote before the members for their approval.. It is mandatory that budget proposal placed shoud be approved only by the supprot of the majority number of members of the house. But regarding the 'majority of the house' the conventionally the rulling party always hold the majority in the house. So the chances of being rejected by the majority has automatically reduced to an impossible proposition. Thus after approval on the Budget proposal, the Comptroller General and Auditr General of India audit the expenditure as well the project viability. On the basis of their Audit Accounts they submitted an extensive report to the Parliament regarding the utilization of sanctioned money as well as the judiciality of expenditure made by the Goverbnebt during a financial yeat. To ensure the control CAG has been given an independent status by the Constitution. Since parliament is too unwieldy body for a serious technical discussion on the report of the CAG , it instantly send to the PAC (Public Accounts Committee). PAC throughly scrutinize the report and audited Accounts and finally submitted to the Parliament with its recommendation and suggestion for action by Government wherever necessary.

The Parliament justify the proposal of Executive for expenditure through the Estimate Committee. The Estimate Committee suggests the probable way for economic development, organizational efficiency or administrative reform. It can also suggest

The second method of control starts immediately after the question hour, which is called '**Zero Hour'**. . At this point, the members put their question in written form. The parliamentary norms are that, before any listed business, the paper so submitted is taken up in the for discussionThe zero hour is usually used to raise matters that are urgent and cannot want wait for the notice period required under other procedure. For raising matters during the zero hour, the members of Parliament give notice before 10 am to the Speaker on the same day.

Committee system is prime instrument of controlling the function of the executive by the legislature. Apart from suggesting some alternative policies in order to bring about efficiency and economy in administration, the committee also select some departments each year, examine their working in great deal and makes suggestion on organization, economy, including policy matters. The Committee of Public Undertakingsexamine public undertakings and evaluate their performance. It also examines different aspects such as implementation of policies programme, management, financial success etc. Committee of Public Undertakings sends the report of CAG after necessary examination to the parliament along with its comments. The Parliament exercise direct control over Public expenditure by examining the reports of the committee on Public Accounts and Estimate Committee.

- **1.08 Conclusion**

Parliament has its own dignity and importance to protect the democracy as main rulling narration. Indian Parliament is an example of organization which runs and conduct its power and ruling privileges by the written documents. Citizen of India exercising their suffrage right elects their representatives. They naturally expect that their representative will properly represent their opinion and sovereign supremacy in the parliament. That duty is done by the elected members through questions and committee. It is imperative that they behave in the prescribed manner to preserve the decorum of the Parliament. The instruments of financial control in India mentioned above can be effective if they are applied with public ethics and morality. The Parliamentary oversight can ensure control or act as a check on the functioning of the government. However, the parliamentarians must take care that there are no disruptions and walkout so that a healthy environment of questioning can be carried out.

- **1.09 Summary**
- We have discussed in detail the historical narration of Legislative control over the finance as well as on the Executive.
- Taking example of historical narration we have discussed the process of financial control of legislature on the finance.
- The relevant Constitutional provisions in support of legisative control over finanace has also been discussed in detail
- Major financial control is imposed on Government's Tax policies, and judicius tax imposition on the citizen. For this reason we have explained that issue here.
- Thus we have come to the point of committee system and discussed the functions of committees of parliament which help the parliament to ensure its control over the executive.

- **1.10 Model Questions**

**Long Questions**:-

1) Discuss in detail, how our Constitutional forefathers has incorporated the necessary provision to ensure the paliamentary control over the finance and executive.
2) Write a detail narration on the process of controlling the Tax system by the Parliament.
3) Discuss the nature of Parliamentary Control over Finance.

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**Middle question.**

1) How Parliament Puts its Control Over Executive with the help of Committees.
2) What are the controlling instrument of legislature to control over the financial activities of the executive.

3) Write a note on the Constitutional provisions on financial control of parliament.

**Short Questions**

**1)** Explain Budgetry control

**2)** Difference between Money Bill and Finance Bill

**3)** Expalin ‘every Administration has its financial implication’.

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# Unit III: Financial Committees: Public Accounts Committee, Estimates Committee

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### 3.0 Learning Objectives

After reading this unit, you should be able

- To understand the composition and function of Public Accounts Committee
- To understand the composition and function of Estimates Committee
- To know about the limitations of both the committees

### 3.1 Introduction

Under the Indian Constitution, Parliament has the prerogative to exercise control over taxation, to grant supplies for public expenditure and control public expenditure. In this context, it can be added that Lok Sabha, the Upper House of Parliament is vested with two types of power of control, entitled—a) pre-budgetary control and post-budgetary control. Post-budgetary control is very significant in the sense that it always tries to scrutinize the budgetary allocation and expenditure. The main instruments of parliamentary control are some financial committees, e.g.—Public Accounts Committee, Estimates Committee and Committee on Public Undertaking. Here we will concentrate on first two committees.

### 3.2 Committee System: Need and Importance

The need for financial Parliamentary control with the help of committee system arose somewhere in the sixteenth century in England and thereafter in the USA. It became popular in France in the eighteenth century and slowly developed in other countries.

In India, the legislative control over finance can be said to have commenced after the year 1919 under the Montague Chelmsford Reforms. The Government of India Act, 1919 introduced the system of control by the Indian Legislature over finance largely modeled on the British system.

The origin of the committee system in India can be traced back to the first legislature after the advent of British rule in India in 1853. The history of committees in India started with the setting up of the Legislative Council in 1854 and a Select Committee in 1856. Public Accounts Committee is one of the four elected oldest committees of the House.

The Parliamentary financial control through committees attempts to ensure that the appropriation of money done by the parliament is spent economically for the approved purposes within the framework of grants. In view of the magnitude of tasks to be performed and within limited time at its disposal, the Parliamentary committees have been constituted. The committees facilitate a methodical and exhaustive assessment of the diverse legislative activities. They ensure supervision and accountability.

There are two kinds of committees — Standing Committees and Ad hoc Committees.

The ad hoc committees are appointed for a specific purpose and their existence ends after it has presented its report. The main ad hoc committees are the select and joint committees on bills.

The Standing Committees are elected or appointed every year or periodically and their work goes on a continuous basis. The three financial committees that we shall be discussing in this unit constitute this category. There are Departmentally Related Standing Committees (DRSCs), too entrusted with tasks of considering demands for grants for various ministries/departments, examining bills referred by the Chairman of Rajya Sabha or Speaker of Lok Sabha and so on.

Now we shall be discussing the composition and functions of the three financial committees of the Parliament.

## 3.3 Public Accounts Committee:

The parliamentary financial tool to monitor the government's financial activities is the Public Accounts Committee (P.A.C.). It is constituted to examine the appropriation accounts and the annual finance accounts of state corporations and other bodies. It also scrutinises the C.A.G. report but not those organisations which have been designated to the Committee on Public Undertakings. The P.A.C. tends to be effective and significant if its recommendations are rightly carried out.

### 3.3.1 Evolution and Composition

**Evolution**

The P.A.C. was set up in 1921 as per the Montague Chelmsford Reforms. The Government of India Act 1919, mandated the Governor-General-in Council to formulate such committees at the Centre as well as the provincial levels so that the accounts of the government are examined to detect any kind of abnormality or deviation from rules and regulations, extravagance, losses, delays, etc.

The 1935 Act included a provision that the report of the P.A.C. must be tabled in the Legislature. Later, the 1947 Act mandated that the Committee would present its report to the President. The Committee on Public Accounts, which is the most prestigious Committee of Parliament, is constituted every year to examine accounts showing the appropriation of sums granted by the Parliament for expenditure of Government of India as mentioned above. The Committee became a Parliamentary Committee on 26th January, 1950.

**Composition**

The P.A.C. consists of 15 members elected by Lok Sabha every year from amongst its members according to the principle of proportional representation by means of single transferable vote. Seven members of Rajya Sabha elected by it in the same manner as the Lok Sabha are associated with the Committee in proportion to its respective strength in both the Houses.

### 3.3.2 Functions of Public Accounts Committee

As discussed above, the P.A.C. examines accounts to check if the government has spent as per the funds appropriated by the government. The functions of the P.A.C. are given below:

1. Examination of Accounts: The P.A.C. examines accounts and the report of the CAG to ascertain that the appropriated funds by the Parliament have been spent with economy and efficiency as per the following conditions:

i) The expenditure must not surmount the funds allocated by the Parliament.

ii) The expenditure has been incurred for the specific activity that it was apportioned by the Parliament.

iii) Only the authorised officials have spent the allocated funds.

iv) The authorised officials have not neglected any vote of Parliament by using it more than a grant.

2. Procedure: The P.A.C. confirms if the procedure used in the maintenance of accounts has been according to the rules and laws. The P.A.C. has the power to call for persons, papers, or records for

the purpose of evidence. Although the committee can report or recommend on a specific item but cannot prohibit any expenditure.

3. Additional Functions: The P.A.C. is supposed to perform these following functions:

i) It scrutinises income and expenditure statement of state corporations, trading and manufacturing schemes and projects.

ii) Examination of accounts of autonomous and semi-autonomous bodies.

iii) It scrutinises the accounts of those stores and stocks of which the CAG has conducted an audit.

4. Tax Administration: The Committee examines various aspects of the government's tax administration like the cases involving under-assessments, tax evasion, non-levy of duties, etc. It also identifies the loopholes in the taxation laws and procedures and makes recommendations to check leakage of revenue.

### 3.3.3 Working Procedure of the Committee

The procedure of the committee is given below in brief:

- The committee works with the Chairperson as its head and guide. He/she is given feedback by the C.A.G. and the Secretary of the Committee to start the procedure of asking the questions.
- The ministry's representatives are asked to appear before the committee to clarify certain questions related to their ministry's accounts. Such meetings are kept private and confidential to maintain secrecy of the witnesses.
- A model/draft report is prepared by the Parliament Secretariat and Chairman to further send it to the C.A.G. for validation.
- The Committee considers it finally and the presents it to the Parliament.
- At times, sub-committees are formed to deal with specific issues.

After a detailed review of all aspects, the report is finalised by the Committee and submitted to the Parliament.

### 3.3.4 Challenges Faced by P.A.C.

- The P.A.C.'s power to scrutinise expenditure provides for Parliamentary oversight over Executive decisions and acts as a check on slackness, negligence and even wrongdoing on the part of the Executive.
- However, the lack of technical expertise hinders the P.A.C.'s examinations. Officers are sometimes able to dodge P.A.C. summons, which has prompted suggestions that it should have the power to hand out harsher punishments.
- In December, the Institute of Public Auditors of India (I.P.A.I.) sought *suo moto* powers of investigation for the P.A.C.
- In April, the P.A.C. had pitched for making the CAG and Auditor General (AG) accountable to Parliament.

**Way Ahead:**

- The report of the All India Conference of Chairpersons of P.A.C.s of Parliament and State/UT Legislatures suggested that the PAC should be consulted on the appointment of the CAG, and that it should have powers to examine Public-Private Partnership projects.

- The report proposed that services of experts should be availed on technical matters, among other suggestions.

### 3.4 Estimates Committee

The Estimates Committee is a financial Committee of the Lok Sabha.

#### 3.4.1 Origin

The origin of Estimates Committee can be traced to the setting up of a standing finance committee in 1921. It was established on the advice of the then-finance minister, John Mathai, during the post-independence era. The Estimates Committee is a Committee of Lok Sabha. The Provisional Parliament approved the motion to elect the first Estimates Committee on April 3, 1950, and the Committee was elected on April 10.

#### 3.4.2 Term of Office

The term of office is one year. A minister cannot be elected as a member of the committee. A new election for the Constitution of the Committee for the coming financial year should be held before the end of the current financial year. The current Committee members will continue to serve until new members are elected if such an election is not held for any reason.

#### 3.4.3 Composition

It had 25 members at first, but that number was increased to 30 at the year 1956. The Estimates Committee consists of members from Lok Sabha only. The Rajya Sabha has no representation in this committee.

#### 3.4.4 Functions

According to Rule 310 of the Rules of Procedure and Conduct of Business in the Lok Sabha, the Committee on Estimates is established to examine any estimates that may seem appropriate to the Committee or that have been formally referred to it by the House or the Speaker. The function of the committee is to look over the estimates made for the budget and suggest 'economies' in public expenditure As a result, it is also referred to as a 'continuous economy committee'. The function of the committee is explained in detail below.

- To report what economies, improvements in organisation, efficiency and administrative reform consistent with the policy underlying the estimates, can be affected

| Estimates Committee at Glance | |
|---|---|
| Founded | 1950 |
| Chairman | Girish Bapat |
| Appointment of Chairman | Speaker of Lok Sabha |
| Tenure | One Year |
| Total members | 30 (Lok Sabha only) |

| | |
|---|---|
| Manner of Election | Principles of proportional representation by means of a single transferable vote |

- To suggest alternative policies in order to bring about efficiency and economy in administration
- To examine whether the money is well laid out within the limits of the policy implied in the
- estimates
- To suggest the form in which the estimates are to be presented to Parliament
- When it comes to public undertakings that are assigned to the Committee on Public Undertakings, the Committee shall not exercise its powers.
- Throughout the financial year, the Committee may periodically continue to examine the estimates and report its findings to the House.
- The Committee shall not be required to review all of the estimates for any year. Even though the Committee has not submitted a report, the demands for grants may still ultimately be voted on.

### 3.4.5 Working

Let's discuss the working of the committee on estimates in detail.

- After the constitution of the Estimates Committee, it selects estimates which are pertaining to a Ministry/Department of the Central Government or such of the statutory and other bodies of the Central Government as may seem appropriate to the Committee.
- The Committee further examines items of particular importance that may emerge or be discovered during its work, matters referred by the House or the Speaker.
- The Committee calls for preliminary materials from the Ministry/Department, statutory and other Government bodies with reference to the topics selected for the examination and also memoranda from non-officials involved with the subjects for the use of the Committee's members.
- The Committee from time to time appoints one or more study groups or subcommittees to conduct in-depth investigations into a variety of subjects.
- With the Speaker's approval, the Committee may decide to make visits to study any specific matter, project, or establishment, either as a whole Committee or by dividing itself into Study Groups, if it appears to the Committee that it is necessary for the purpose of its examination that an on-the-spot study should be made.
- The pertinent Ministries/Departments, etc., are contacted in advance to request notes regarding the institutions/offices, etc., to be visited. These notes are then distributed to the members of the Committee/Sub Committee/Study Group.

- Only informal meetings are held at the site of the visit when the committee, subcommittee, or study group is there on a study visit. Such meetings don't record any evidence or make any decisions.

- All meetings between the Committee and representatives of Ministries/Departments, non-official organisations, etc. are confidential, and anybody with access to them is not allowed to share any details regarding the topics discussed with the press or other unauthorised parties.

- Official and nonofficial witnesses are later invited to testify at formal meetings of the Committee held in the Parliament House Complex in New Delhi, taking into account informal discussions during Study Visits, memoranda received from non-officials, information gathered from the Ministry/Department concerned, and other sources.

- The committee's observations and recommendations are included in the reports it submits to the Lok Sabha.

- The Ministry or Department in question must act on the Observations/Recommendations findings included in the Report within six months of the Report being presented to Lok Sabha, or as otherwise instructed by the Committee.

- After the Committee has reviewed the Government's responses, a report on the actions taken is given to Lok Sabha. Statements are placed on the Lok Sabha's table as responses to the suggestions found in the Action Taken Reports.

### 3.4.6 Limitations

The following factors limit the Estimates Committee's ability to do its job effectively:

- It cannot question the policy laid down by the Parliament.

- It examines every year only certain selected ministries and departments. Thus, by rotation, it would cover all of them over a number of years.

- It does not examine the budget estimates before they have been voted on by the Parliament.

- Its recommendations are advisory and not binding on the ministries

- Its work is in the nature of a post mortem work i.e. it examines the expenditure which has already been done by the government.

- The expert assistance of the C.A.G. is available to the Public Accounts Committee but not to the Estimates Committee

## 3.5 Conclusion

To conclude it can be stated that the said instruments of parliamentary control i.e. P.A.C. and E.C. have been working significantly in their own field. Formation of P.A.C. shows that it does not work as an agent of any specific political party, because different representatives of important political parties are incorporated here. A former Speaker of Lok Sabha aptly comments, "…the association of the members of the opposition assures all that the government spending is going to be scrutinised with no special tendencies." On the other hand, through the reports of E.C. common people could learn about the governmental activities. The main objective of E.C. is not only limited to criticism, but to accumulate knowledge about constructive discussion, observation etc. P. R. Jena rightly remarks, "When any technical issue emerges for discussion, then the members of E.C. use to accept opinions from both official and non-official experts."

## 3.6 Summary

- The Public Accounts Committee (P.A.C.) is a committee of selected members of Parliament, constituted by the Parliament of India, for the purpose of auditing the revenue and the expenditure of government of India.
- The Estimates Committee is a committee of selected members of Parliament, constituted by Lok Sabha for the purpose of scrutinising the functioning of government's ministers and departments in terms of expenditure and utilisation of funds.

## 3.7 Glossary

- **Montague Chelmsford Reforms:** The government of India Act, 1919also known as the Montague Chelmsford Reforms came into force in 1921. It was instituted in the British Indian Polity to introduce the diarchy, that is, the rule of two, the executive councilors and the ministers.
- **The Committee on Public Undertakings (C.P.U.):** It was established in 1964. Its main function is to:
  - i. Examine the reports and accounts of the public undertakings.
  - ii. Scrutinise reports of the CAG on the public undertakings.
  - iii. Carry out any other functions of P.A.C. and E.C. with respect to public undertakings.

## 3.8 Model Questions

**Long answer type questions:**

1. Explicate the composition and functions of Public Accounts Committee.
2. Discuss the composition and functions of Estimates Committee.
3. What are the limitations of Estimates Committee?

**Medium answer type questions:**

1. Examine the challenges faced by Public Accounts Committee.
2. Evaluate the works of Estimates Committee.
3. Mention the tenure of members of Estimates Committee.

**Short answer type questions:**

1. In which year Public Accounts Committee was set up?
2. How many members are in P.A.C.?
3. In which year Estimates Committee was formed?

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# Unit IV: Accounts and Audit: Role of C.A.G.

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## 4.0 Learning Objectives

After reading this unit, you should be able

- To know about the importance of accounting
- To understand the main forms of government accounts
- To have some ideas regarding accounting system of India
- To understand the importance of audit
- To know about audit system of India
- To realise the role of C.A.G. in India

## 4.1 Introduction

Financial administration seeks to raise, spend and account for the Fund needed for public expenditure. Sound fiscal administration is of vital importance to government. As revenue is derived from the citizens, it is morally incumbent upon government to spend money efficiently and economically. Unsound financial administration may destroy the prospects of democracy itself. It is apt here to mention that the unprecedented increase in government expenditure in modern times makes it essential that sound principles, tools and techniques of financial administration should be employed by all governments. It involves the activities of four agents: the executive which needs and spends the funds, the legislature which grants the funds and appropriates them to particular ministries and departments, the finance ministry which controls the expenditure and audit which sits in judgment over the way in which the funds have been spent. In this context it is worthy to mention the role of C.A.G. of India which is regarded as the supreme audit institution in India, establish under Article 148 of the Constitution of India. This institution is vested with the power to audit all receipts and expenditure of the government of India and the state governments including those of autonomous bodies and corporations substantially financed by the government. So in this unit the importance of accounts and audit as well as the role of C.A.G. will be discussed.

## 4.2 Accounting

Accounting means keeping a systematic record of financial transactions whether of a public authority or private concern or individual. According to L.D. White, "The primary functions of system of accounts are to make a financial record, to protect those handling funds, to improve the financial condition of the organisation in all its branches or purposes at any time, to facilitate necessary adjustment in rate of expenditure, to give information to those in responsible positions on the basis of which plans for future financial and operating programmes can rest, and to aid in the making of an audit."

Accounting is an indispensable means of exercising financial control. It is only through systematic accounts supported by vouchers and receipts that the legality and honesty of the transactions can be determined. Accounts are important by way of record of what was received and paid. Such record is essential to prevent the neglect of demands of dues and double payments, through forgetfulness. Accounts furnish valuable data for the formulation of financial as well as general policy and programmes.

Through accounts the authorities can know whether a particular activity or programme of the Government is self-supporting or involves a burden on the public exchequer, and if the latter, whether it should be continued or expanded or not. Scientific budget preparation would be impossible without the help of accounts.

**The Form of Governmental Accounts:** The form of Governmental accounts differs from the business and commercial accounts, because the objects of the two are different. Business and Commercial accounts are so kept as to facilitate the preparation of the balance sheet showing profit or loss, and assets and liabilities. Government is not for profit but for service to the people. So the object of Government accounting is to furnish data to show whether the provisions of the budget as voted by the legislature have been observed or not. The Government accounts, therefore, follow the budgetary form. In India, the form of the accounts of the Union as well as of the States is prescribed by the Comptroller and Auditor-General of India, with the approval of the President. In practice, the budget form corresponds to the form of accounts as prescribed by the Comptroller and Auditor General. The main forms of Government accounts are as follows:

**(i)** **Control Accounts:** The main objective is to ensure fidelity on the part of officers having the duties of collection, custody, disbursement and the ensuring of rigid adherence to all directions and limitations to levy and collect income and make expenditure. With this end in view, every Government maintains its Revenue Accounts (accounts for each head of income), Appropriation Accounts (accounts for each major and minor head of expenditure), and Fund Accounts (accounts of different funds which Government maintains).

**(ii)** **Proprietary Accounts:** The proprietary accounts are kept mainly from the point of view of the convenience of internal administration. They do not serve the purpose of the interested external parties, namely the legislature and the public. For this, supplementary accounts are maintained. These accounts are called 'Proprietary Accounts'.

**(iii)** **Supplementary Detailed Accounts:** Detailed accounts, regarding the assets and liabilities1, receipts and expenditure of the Government received from different viewpoints may be maintained and published after one or two years for the information of the public.

**The Account-Keeping Agency in India:** According to the theory of financial administration, keeping of the accounts should be a function of the executive authorities. But in India, the duty of keeping the accounts of the Union (except the Railway and the Defence Accounts) as well as the State devolves upon the Comptroller and Auditor-General of India and his staff. Under the Comptroller and Auditor-General there is in each state an Accountant-General in whose office the accounts of the transactions taking place within the territorial limits of that state are kept. Railway accounts are kept by the Financial Commissioner for Railways, and Defence accounts, by the Finance Ministry through the Financial Adviser (Defence) and the Military Accountant-General.

### 4.2.1 Types of Accounting System

**(a) Double-entry Book Keeping:** Under this system every item of expenditure is entered at two places. One entry remains with the operating service while another is sent to the accounts office, if there is a separate department of the Government or to the controlling officer of the same service. The merit of this system is that if an error is to be deliberately made, it will have to be made at two places, which is a difficult task.

**(b) Cost Accounting:** It is the determination of inclusive costs per unit. It may be applied in production, unit cost of a commodity manufactured in a Government, or even in service. This system is mostly made use in the Public Works Department. The utility of this system is that the costs may be compared in a single institution or single operation over successive periods of time and the comparative costs of similar operations in different agencies or in different jurisdictions may be determined.

**(c) Accrual Accounting System:** It is that system of accounting by which the right to a receipt, or the obligation to make a payment, is established or as is technically called, accrues. Under this system, appropriate entry is made in the account books of all actions having for their result an undertaking with the right to an asset or placing it under an obligation to pay. This system is followed in France. The main advantage of this system is that it gives detailed information regarding every transaction of the Government.

**(d) Cash Accounting System:** Under this system, the right to a receipt, or the obligation to make a payment, is realised upon, or as the technical term goes, is liquidated. It seeks to record only those operations in which an actual transfer of cash has taken place. Most Governments use the cash accounting system because of its simplicity.

### 4.2.2 Accounting System in India

There are four stages in the building up of accounts. These are as follows:

**(i)** **Initial Entry:** In each district, there is a Government treasury under the charge of a Treasury Officer. The treasury is maintained at the cost of the State Governments. Every financial transaction is separately recorded in the treasure. On the 11th and 1st of each month, the Treasury Officer sends a list of payments made during these intervals, supported by vouchers, to the Accountant-General. In case of the Railways, Post and Telegraph, Public Works Department and Forest Department, receipts are paid in the treasury in lump, while detailed accounts are kept by the departmental officers.

**(ii)** **Classification of Accounts by the Accountant-General:** All accounts of the previous month reach the office of the Accountant-General by the 1st of next month. The accounts are classified in order to secure uniformity in accounting and also in order to help in the preparation of budget forecasts. There are four different types of accounts in India: They are:

(1) Revenue Accounts: These deal with all proceeds of taxation and other payments classed as 'revenue' and all expenditure there from.

(2) Capital Accounts: These deal with expenditure met from borrowed funds and accumulated cash balances.

(3) Debt Accounts: These deal with the receipts and payments in which Government either becomes liable to repay the moneys received or becomes entitled to claim to recover the amount paid.

(4) Remittance Accounts: Relate to all such transactions as are not covered by the previous categories. Each one of these accounts is divided into major heads. Parliament makes money grants on 'major heads' which are further divided into 'minor heads' which are sub-divided into 'subheads' which, in turn, are further divied into 'detailed heads'. Revenue heads are numbered in the Roman figures, (I, II, III, IV, etc.) and expenditure heads are numbered in the Arabic figures, (1, 2, 3, 4, etc.).

**(iii)** **Monthly compilation:** Before compilation, accounts are audited by the Auditor. Then they go to the accounts officers who compile them every month and submit them to the Government by the end of the following month.

**(iv)** **Annual compilation:** This is done by the Comptroller and Auditor-General of India. The Comptroller and Auditor-General's department prepares the final accounts of the Union and State Governments in two forms — The Appropriation Accounts and the Finance Accounts. The Appropriation Account is an account comparing the total grants, original and supplementary, made by Parliament for particular purposes for a financial year with the actual expenditure incurred for these purposes during the year. The Public Accounts Committee examines this account. Subsidiary accounts such as the profit and loss accounts and balance sheet of the commercial undertakings of the Government, stores accounts, works accounts, etc., are appended to the Appropriation Account to give details of expenditure concerning these.

The Finance Account is a comprehensive account of the receipts and expenditure of the Government (Union or State) classified under the various heads and sub-heads of the budget.

Besides these, the Audit and Accounts department also prepares a General Financial Statement called the 'Combined Finance and Revenue Accounts of the Central and State Governments', giving a summary of the accounts of the Union and of all the State Governments for the preceeding financial year and showing their balances and outstanding liabilities. They are submitted to the President or the Governor, as the case may be, sometimes in January or February, of the following year and are then laid before the Parliament or the State Legislature, as the case may be, at the Budget Session.

### 4.3 Audit:

Audit is the development of the 19th century and is inevitably an indispensable part of the parliamentary control of public finance. Audit means an examination of accounts with a view to determine the correctness of these accounts and of the transactions they embody.

According to James C. Charlesworth, "Audit means the process of ascertaining whether the administration has spent or is spending its funds in accordance with the terms of the legislative instrument which appropriated the money."

A thorough-going audit should be an audit

(a) against laws, rules and regulations

(b) against appropriations as voted in the budget

(c) against sanctions, and

(d) against canons of financial propriety.

Of these criteria (a) to (c) seek to judge the legality, while canons of financial propriety are intended to check improper and wasteful expenditure.

#### 4.3.1 Audit Organization in India

The audit and accounting functions in India are combined in the hands of one organisation, the Indian Audit Department, headed by the Comptroller and Auditor-General of India. Independent audit emerged in 1919 with the inauguration of the Montague-Chelmsford Reforms. The Government of India Act, 1935 further improved its status by giving it constitutional recognition and by requiring its appointment to be made by His Majesty. The Department was given the same status as of judges of the Federal Court. With the enactment of Constitution in 1950, the Auditor-General of India was re-designated as the Comptroller and Auditor-General of India Historically speaking, the creation of such an office was the product of Gladstone's ingenious mind, when he was Chancellor of the Exchequer in the British Cabinet. He got the Exchequer and Audit Act passed through the British Parliament in 1866, which led to the establishment of the office of the Comptroller and Auditor-General. In the U.S.A., the office of the Comptroller and Auditor-General in its present form came into existence when the Budget and Accounting Act of 1921 was passed.

**Audit in India**

Audit of Government accounts (including the accounts of the States) in India is a Union subject and is entrusted to the Comptroller and Auditor-General of India.

Indian audit is governed not by law, but by an executive order — the Government of Indian Audit and Accounts Order 1936 as adopted under the Indian (Provisional Constitution) Order of 1947.

Audit in India is primarily concerned with expenditure. Its concern with receipts is limited to those items only which it may be required by the executive to undertake, or may undertake with its approval. At present the receipts of Railways, Posts and Telegraph and Customs are subject to audit while other receipts including those from Income-tax are not.

Audit should really be an arm of the legislature to assist it in seeing that its wishes and decisions as expressed in the budget are respected. The Constitution requires that the report of the Comptroller and Auditor-General relating to accounts shall be laid before each House of Parliament but technically, the audit is conducted on behalf of the Executive and its reports are submitted to the Executive (the President in case of the Union, and the Governor in case of States) which causes them to be laid before the Legislature.

Finally, Indian audit is primarily a legality audit. The Government of Indian Audit and Accounts Order under which it is conducted, requires the Comptroller and Auditor-General to ascertain whether moneys shown in the accounts as having been disbursed were legally available for and applicable to the purpose to which they had been applied and whether the expenditure conforms to the authority which governs it.

### 4.3.2 The Audit Report

Audit results in the certification of the accounts by the Comptroller and Auditor-General as correct subject to such comments and remarks as he may choose to make, and in the preparation of an audit report for each of the Governments whose accounts are audited. This report is presented, in case of the Centre, to the President, and in case of the States, to the Governors. These heads are required, by the Constitution, to cause these reports to be laid before their several Legislatures. The Legislatures refer the reports to their Public Accounts Committees of which there is one at the Centre as well as one in each of the states, for examination of the report. The audit reports contain the comments of the audit authorities on the correctness or otherwise of the expenditure and other financial transactions. Particularly they point out the more important financial ir-regularities, the cases of budgetary grants being exceeded, failure to obtain the necessary sanction for expenditure, non-compliance with rules and regulations, cases of improper or wasteful expenditure, and of misappropriation and embezzlement. The audit reports are examined by the Public Accounts Committee and the committee reports upon it.

**Performance Audit**: Performance audit means an appraisal of accomplishment. In India, it is called efficiency-cum performance audit. Broadly, the purpose of such audit would be to ascertain whether: (a) such undertakings are being run efficiently and their operations conducted economically. (b) They are producing the results expected of them.

### 4.3.3 Separation of Accounts from Audit

In India, the twin functions of maintenance of accounts and their audit had remained combined in the same hands until 1976. The Comptroller and Auditor-General was entrusted with both sets of functions. In Britain, on the other hand, there is separation of accounts from audit, the former function is performed by the Heads of Departments in the capacity of Accounting Officers.

The audit department has no concern with the compilation of accounts which, of course, is rescrutinised by it on behalf of Parliament to which the report of its examination is submitted. Excepting the Departments of Defence and Railways where accounts were compiled by the departments themselves, these functions have been combined in India.

This arrangement was unequivocally criticised by successive commissions. The Muddiman Committee (1924), the Inchcape Committee on Retrenchment (1923) as well as the Simon Commission (1929) recommended the separation of accounts from audit as a necessary financial reform. P. K. Wattal has emphasised the desirability of separating these two functions by remarking, "Accounting is essentially an executive function and must be under the control of the executive head of the department. Auditing is a quasi-parliamentary function, which involves a checking of the works done by the executive authorities for report to the Parliament. A combination of these two essentially distinct functions in a parliamentary officer is good neither for the executive ad-ministration nor for the Parliament. It is almost as bad as combination of executive and judicial functions. In every modern administration, accounting and auditing functions should be kept distinct and separate from each other. It is only then that the auditor's certification regarding the correctness of the accounts has any meaning. Where there is a combination of functions, there is necessarily a contradiction in as much as the officer compiling the account is also the officer who certifies its correctness."

In 1976, the Central Government separated accounting from the audit, and since that year the Comptroller and Auditor-General of India has been relieved of the responsibility for compiling of the accounts of the Central Government and is concerned with the audit of accounts only.

Consequent upon the separation of accounts from the audit, a Controller-General has been appointed in the Central Government to be the technical authority heading the new accounting set-up. He is in charge of the final compilation of accounts.

### 4.4 Comptroller and Auditor General (C.A.G.)

*"I am of the opinion that this dignitary or officer is probably the most important officer in the Constitution of India. He is the one man who is going to see that the expenses voted by Parliament are not exceeded, or varied from what has been laid down by Parliament in the Appropriation Act*."

—Dr. B.R Ambedkar

C.A.G. is an independent authority under the Constitution of India. He is the head of the Indian audit & account department and chief Guardian of Public purse. It is the institution through which the accountability of the government and other public authorities (all those who spend public funds) to Parliament and State Legislatures and through them to the people is ensured.

#### 4.4.1 Origin

- Office of the Accountant General was established in 1858 (the year the British took over administrative control of India from the East India Company). In 1860 Sir Edward Drummond was appointed as the first Auditor General.

    - Meanwhile after some restructuring the Auditor General of India came to be called the Auditor and Accountant General to the Government of India.

- In 1866, the position was renamed Comptroller General of Accounts, and in 1884, it was re-designated as Comptroller and Auditor General of India.
- Under the Government of India Act 1919, the Auditor General became independent of the government as statutory backing was given for the position.
    - The Government of India Act 1935 further strengthened the position of the Auditor General by providing for Provincial Auditors General in a federal set-up.
    - The act also described the appointment and service procedures and gave a brief overview of the duties of the Auditor General of India.
- The Accounts and Audits Order of 1936 provided detailed accounting and auditing functions of the auditor general.
- This arrangement remained unchanged until India's independence in 1947. After independence, Article 148 of the 1949 Indian Constitution provided for the establishment of a Comptroller and Auditor General to be appointed by the President of India.
    - CAG jurisdiction was extended to Jammu and Kashmir in 1958.
- In 1971 the central government enacted the Comptroller and Auditor General (Duties, Powers, and Conditions of Service) Act, 1971. The act made CAG responsible for both accounting and auditing duties for central and state governments.
    - In 1976 CAG was relieved from accounting functions.
- CAG has undergone rapid computerization and modernization since the 1990s and pervasive nature of Indian corruption has kept CAG vigilant and it has audited and investigated some of the worst and most controversial corruption scandals in Indian history.

### 4.4.2 Constitutional Provisions

- **Article 148** broadly deals with the CAG appointment, oath and conditions of service.
- **Article 149** deals with Duties and Powers of the Comptroller and Auditor-General of India.
- **Article 150** says that the accounts of the Union and of the States shall be kept in such form as the President may, on the advice of the CAG, prescribe.
- **Article 151** says that the reports of the Comptroller and Auditor-General of India relating to the accounts of the Union shall be submitted to the president, who shall cause them to be laid before each House of Parliament.
    - The reports of the Comptroller and Auditor-General of India relating to the accounts of a State shall be submitted to the Governor of the State, who shall cause them to be laid before the Legislature of the State.

- **Article 279 –** Calculation of 'net proceeds' is ascertained and certified by the Comptroller and Auditor-General of India, whose certificate is final.
- **Third Schedule –** Section IV of the Third Schedule of the Constitution of India prescribes the form of oath or affirmation to be made by the Judges of the Supreme Court and the Comptroller and Auditor-General of India at the time of assumption of office.
- **Sixth Schedule** – According to this schedule, the District Council or Regional Council should be kept in such form as the CAG prescribes with the approval of the President. In addition these bodies account are audited in such manner as CAG may think fit, and the reports relating to such accounts shall be submitted to the Governor who shall cause them to be laid before the Council.

### 4.4.3 Functions and Power of C.A.G.

C.A.G. derives its audit mandate from different sources like–

- Constitution (Articles 148 to 151)
- The Comptroller and Auditor General's (Duties, Powers and Conditions of Service) Act, 1971
- Important Judgments
- Instructions of Government of India
- Regulations on Audit & Accounts-2007

C.A.G. audits the accounts related to all expenditure from the Consolidated Fund of India, Consolidated Fund of each state and UT's having a legislative assembly. He audits all expenditure from the Contingency Fund of India and the Public Account of India as well as the Contingency Fund and Public Account of each state. He audits all trading, manufacturing, profit and loss accounts, balance sheets and other subsidiary accounts kept by any department of the Central Government and the state governments. He audits the receipts and expenditure of all bodies and authorities substantially financed from the Central or State revenues; government companies; other corporations and bodies, when so required by related laws. He audits the accounts of any other authority when requested by the President or Governor e.g. Local bodies. He advises the President with regard to prescription of the form in which the accounts of the Centre and States shall be kept. He submits his audit reports relating to the accounts of the Centre to the President, who shall, in turn, place them before both the houses of Parliament. He submits his audit reports relating to the accounts of a State to the Governor, who shall, in turn, place them before the state legislature. C.A.G. also acts as a guide, friend and philosopher of the Public Accounts Committee of the Parliament.

### 4.4.4 Criticism

Paul H. Appleby, in his two reports on Indian Administration, was very critical of the role of CAG and attacked the significance of his work. He also suggested that the CAG should be relieved of the responsibility of audit. In other words, he recommended the abolition of the office of CAG. His points of criticism of Indian audit are as follows:

1. The function of the C.A.G. in India, is in a large measure, an inheritance from the colonial rule.

2. The C.A.G. is today a primary cause of widespread and paralysing unwillingness to decide and to act. Auditing has a repressive and negative influence.

3. The Parliament has a greatly exaggerated notion of the importance of auditing to Parliamentary responsibility, and so has failed to define the functions of the C.A.G. as the Constitution contemplated it would do.

4. The C.A.G.'s function is not really a very important one. Auditors do not know and cannot be expected to know very much about good administration; their prestige is highest with others who do not know much about administration.

5. Auditors know what is auditing, which is not administration; it is a necessary, but a highly pedestrian function with a narrow perspective and a very limited usefulness.

6. A deputy secretary in the department knows more about the problems in his department than the C.A.G. and his entire staff.

### 4.5 Conclusion

To conclude it can be stated that financial administration is a dynamic process which falls into few well-defined divisions. Among these divisions, the important one is rendering of the accounts by the executive and the audit of this account. Until 1976 the twin functions of maintenance of accounts and there audit had remained combined in the same hand. The C.A.G. was entrusted with both sets of functions.

### 4.6 Summary

- The financial administration is a part of general administration. The purpose of public administration is to observe that the money sanctioned by the legislature for development and other purposes has been properly spent and the performance of the financial administration is quite satisfactory.
- The financial administration cannot go beyond the general principles. The budget and the allied ideas are settled by the finance department. This is not all. The functions of financial administration are scrutinised and audited by the C.A.G. of India. This is a very powerful constitutional authority of India.

### 4.7 Glossary

- **Systems Audit:** It is carried out to determine if the information system in place is making sure the data integrity, safeguarding the organisation's assets operating efficiently to help the organisation in achieving its goals and objectives.
- **Contingency Fund:** It is a reserve of money set aside to cover possible unforeseen future expenses. The Contingency Fund of India is established under Article 267 (1) of the Indian Constitution.
- **Consolidated Fund:** All revenues received by way of taxes like income tax, central excise, customs and other receipts flowing to the government in connection with the conduct of government business that is non-tax revenues are credited into the Consolidated Fund constituted under Article 266 (1) of the Constitution of India.

### 4.8 Model Questions

**Long answer type questions:**

4. What are the functions and powers of C.A.G.?
5. How did the office of the C.A.G. come into being?
6. Write a note on accounting system in India.

**Medium answer type questions:**

4. What are the constitutional provisions regarding the C.A.G.?
5. What are the different types of accounting system?
6. Give an account of audit organisation in India.

**Short answer type questions:**

4. What is the difference between accounting and auditing?
5. What is the most important element of an audit?
6. How independently does the office of C.A.G. function?

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# Unit V: Role of R.B.I

## Structure

### 5.1 Objectives

- Understand the history of Reserve Bank of India
- Explain its organizational structure.
- Discuss the functions of R.B.I

### 5.2 Introduction

The Reserve Bank of India, known as R.B.I is India's Central Bank and regulatory body responsible for regulation of the Indian banking system. It is under the control of Ministry of Finance, Government of India. It is responsible for the control, issue and maintaining supply of the Indian currency (rupee). The basic functions of the RBI are sustaining monetary stability in India, operating the currency, and maintaining the country's credit system. It advises central and state governments in better cash management; works towards establishment of modern, robust, efficient, secure, and integrated payment and settlement system for the country.

### 5.3 Origin and Evolution

The origin of the Reserve Bank can be traced to 1926, when the Royal Commission on Indian Currency and Finance—also known as the Hilton-Young Commission— recommended the creation of a central bank to separate the control of currency and credit from the government and to augment banking facilities throughout the country. The Reserve Bank of India Act of 1934 established the Reserve Bank as the banker to the central government and set in motion a series of actions culminating in the start of operations in 1935. Since then, the Reserve Bank's role and functions have undergone numerous changes keeping pace with the changing nature of the Indian economy.

From ensuring stability of interest rates and exchange rates to providing liquidity and an adequate supply of currency and credit for the real sector; ensuring banking penetration and safety of depositors' funds to promoting and developing financial institutions and markets, and maintaining the stability of the financial system through continued macro-financial surveillance; the Reserve Bank plays a crucial role in the economy of the country. Its decisions touch the daily life of all Indians and it helps chart the country's current and future economic and financial course. Over the years, the Bank's specific role and functions have evolved, while some functions have been added in, others have gradually reduced or moved to other organizations such as EXIM Bank, NABARD, IDRBT, IFTAS, etc. Through all the changes the integrity and professionalism with which the Reserve Bank discharges its mandate remains constant

### 5.4 Presence

The Reserve Bank of India has regional offices (ROs) including Sub-offices at 31 locations spread across the country. In 2022, RBI opened a Regional Office for the State of Andhra Pradesh, which is working out of the Bank's Hyderabad Regional Office premises for now.

## 5.5 Organizational Structure

A. The Governor (Chief Executive Authority)
Deputy Governors

Executive Directors

Principal Chief General Managers / CGMs

General Managers / Deputy General Managers

Assistant General Managers / Managers

Assistant Managers / Assistant

Support Staff

B. Central Board of Directors
Local Board
Committee of the Central Board
Board for Financial Supervision
Board for Payment & Settlement Systems
Sub-Committees of Central Board viz HRM-SC, ARMS, Building-SC, IT-SC, Strategy-SC
Other Committees such as Deputy Governors' Committee
Senior Management Committee, Executive Directors' Committee Local Boards

## 5.6 Functions and Working

A. Regulation, Supervision and Enforcement

Legal Framework: The regulatory and supervisory activities of the Bank derive authority from various provisions contained in statutes such as RBI Act, 1934, BR Act, 1949, BR Act (AACS), 1949, the Regional Rural Banks Act, 1975, SARFAESI Act, 2002, Payment and Settlement Systems Act, 2007, etc. The Bank undertakes these roles to protect depositors' interests, to ensure safety and soundness of the banking system and to safeguard financial stability.

Organisational Set-up: Viewing the different entities within its domain in a unified manner and in order to derive regulatory / supervisory synergies, the Bank has set up two new Departments – the Department of Regulation (DoR) and the Department of Supervision (DoS) in 2019 thereby bringing commercial banks, cooperative banks and NBFCs under a single umbrella.

B. Financial Markets & Foreign Exchange

Legal Framework :

- FMRD & FMOD - Chapter III D, RBI Act, 1934, FEMA, 1999, PSS Act, 2007, Bilateral Netting of Qualified Financial Contracts Act, 2020
- IDMD - Government Securities Act, 2006/Rules 2007, Public Debt Act, 1944/ Rules 1946
- DEIO RBI Act, 1934
- FED - FEMA, 1999

Focus Areas: Financial Markets Departments are committed to further developing and deepening the money, G-secs, foreign exchange, interest rate and currency derivative markets, ensuring effective liquidity management and stability in exchange rate through FX operations. IT infrastructure is being continuously ramped up for effective monitoring and surveillance e.g. Public Registry, Integrated Market Surveillance System, etc. These departments aim at rationalisation of cross-border borrowing and lending regulations as also improving information management in the context of foreign investment inflows while facilitating outward flows.

C. Banking, Currency Management, Payment Systems & FinTech

Legal Framework

- DGBA Sections 20-21, 21A & 53 of RBI Act, 1934
- DCM Chapter-III, Section 22-28, RBI Act, 1934
- DPSS Payment and Settlement Systems Act, 2007/Regulations 2008
- FinTech RBI Act, 1934

Focus Areas:

- DGBA: E-Kuber (RBI's Core Banking System), Integration with Governments/ Treasuries, Internal Accounting Review and monitoring.

- DCM: Capacity enhancement, Indigenisation of Banknotes, Varnished banknotes-field trial, improving Currency Management Infrastructure, etc.

- DPSS: To provide Safe, Secure, Fast, Convenient, Accessible, and Affordable E-Payment options for Everyone, Everywhere and Everytime.

- FinTech Department: Regulatory Sandbox, Central Bank Digital Currency (CBDC), Coordinating with Reserve Bank Innovation Hub, select aspects of regulation (Account Aggregator/Peer-to-Peer), Co-operation with Domestic and International Standard Setting Bodies & Liaisoning with National and International Committees on Innovation/ Technology

D. Monetary Policy, Research & Financial Stability

Legal Framework: Preamble to the Reserve Bank of India Act, 1934, "...to regulate the issue of Bank notes and keeping of reserves with a view to securing monetary stability in India and generally to operate the currency and credit system of the country to its advantage; to have a modern monetary policy framework to meet the challenge of an increasingly complex economy, to maintain price stability while keeping in mind the objective of growth".

Focus Areas:

- MPD: Assessment & outlook of inflation and growth, refining liquidity forecasting framework and its operating aspects, Monetary Policy transmission analysis, analysis of sectoral credit flows, macro modelling.

- DEPR: Big data applications for improving inflation and growth projections, payment systems innovations and currency demand, global liquidity and impact of trade policy measures, determinants of total factor productivity, supply chain and food inflation dynamics.

- DSIM: Managing Centralised Information Management System (CIMS), collection & analysis of unstructured big data for policy impact, Central Information System for Banking Infrastructure (CISBI), metadata driven data maintenance and dissemination system.

- International Department: Finance track under G20, Article IV 2019 with IMF, FSB's annual monitoring exercise, analytical policy briefs at BIS and CGFS meetings, SAARCFINANCE.

- FSU: Macroprudential surveillance, preparation of financial stability reports, conduct of systemic stress tests and development of models, secretariat to the FSDC-SC.

### 5.7 Conclusion

The reserve bank is a non-political body concerned with the finances of the country. Its developmental role includes ensuring credit to productive sectors of the economy, creating institutions to build financial infrastructure, and expanding access to affordable financial services. India's economy experienced a significant degree of growth since the early 2000s. According to the World Bank Report, the country implemented policies to help get more than 90 million people out of poverty between 2011 and 2015. Despite its rapid growth rate, the Indian economy has weakened - both before and during the global COVID 19 pandemic hit. The World Bank estimated India's GDP to be more than $2.6 billion as of 2020, making it the sixth largest in the world after the USA, China, Japan, Germany, and the United Kingdom. In conclusion, we can say that the Reserve Bank of India is playing an important and crucial role in the economic development of India.

### 5.8 Summary

- In this unit, the origin and evolution of the R.B.I has been explained.
- We have discussed the structure, functions, and the role of the R.B.I

### 5.9 Glossary/Keywords

- Financial Markets: Any place or system that provides buyers and sellers the means to trade financial instruments.
- Monetary Policy: A set of actions to control a nation's overall money supply and achieve economic growth.
- Legal Framework: The primary pieces of legislation governing the banking sector in India.

### 5.10 Model Questions

1. Discuss in brief, the origin and evolution of the Reserve Bank of India.
2. Describe the organizational structure of the R.B.I
3. Discuss the important functions of the R.B.I in the context of financial markets and foreign exchange.
4. Examine the role of the R.B.I in the sphere of currency management.
5. Discuss the developmental role of the R.B.I with special reference to economic inclusion.

## 5.11 Further Readings and References

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