



NETAJI SUBHAS OPEN UNIVERSITY

STUDY MATERIAL

P.G.P.A.

PAPER VI

MODULES : 1-4

**POST GRADUATE
PUBLIC
ADMINISTRATION**

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STUDY MATERIAL

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PAPER V

MODERN

POST GRADUATE

DEGREE

ADMINISTRATION

PREFACE

In the curricular structure introduced by this University for students of Post Graduate degree programme, the opportunity to pursue Post Graduate course in Subjects introduced by this University is equally available to all learners. Instead of being guided by any presumption about ability level, it would perhaps stand to reason if receptivity of a learner is judged in the course of the learning process. That would be entirely in keeping with the objectives of open education which does not believe in artificial differentiation.

Keeping this in view, study materials of the Post Graduate level in different subjects are being prepared on the basis of a well laid-out syllabus. The course structure combines the best elements in the approved syllabi of Central and State Universities in respective subjects. It has been so designed as to be upgradable with the addition of new information as well as results of fresh thinking and analyses.

The accepted methodology of distance education has been followed in the preparation of these study materials. Co-operation in every form of experienced scholars is indispensable for a work of this kind. We, therefore, owe an enormous debt of gratitude to everyone whose tireless efforts went into the writing, editing and devising of a proper lay-out of the materials. Practically speaking, their role amounts to an involvement in invisible teaching. For, whoever makes use of these study materials would virtually derive the benefit of learning under their collective care without each being seen by the other.

The more a learner would seriously pursue these study materials the easier it will be for him or her to reach out to larger horizons of a subject. Care has also been taken to make the language lucid and presentation attractive so that they may be rated as quality self-learning materials. If anything remains still obscure or difficult to follow, arrangements are there to come to terms with them through the counselling sessions regularly available at the network of study centres set up by the University.

Needless to add, a great part of these efforts is still experimental—in fact, pioneering in certain areas. Naturally, there is every possibility of some lapse or deficiency here and there. However, these do admit of rectification and further improvement in due course. On the whole, therefore, these study materials are expected to evoke wider appreciation the more they receive serious attention of all concerned.

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Vice-Chancellor

POST OFFICE DEPARTMENT

PROG. 1

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Module-I ● Unit 1 □ Financial Administration

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1.0 □ Introduction

Financial administration took its evolving shape first during the great Mughal Akbar's regime. All economic matters fell under the jurisdiction of the *wazir*, assisted Principally by three ministers to look separately after the crown lands, the salary drafts and *jagirs*, and the records of fiscal transactions. At almost all levels, the revenue and financial administration was run by a cadre of technically proficient officials and clerks drawn mainly from Hindu service castes—Kayasthas and Khatriis.

More significantly, in local and land revenue administration, Akbar secured support from the dominant rural groups. With the exception of the villages held directly by the peasants, where the community paid the revenue, his officials dealt with the leaders of the communities and the superior landrights holders (*zamindars*). The *zamindar*, as one of the most important intermediaries, collected the revenue from the peasants and paid it to the treasury, keeping a portion to himself against his services and *zamindari* claim over the land.

Financial Administration has the primary responsibility for the fiscal integrity of any organization. It is expected to provide a financial environment that is secure, encourages the accomplishment of missions, provides timely and accurate information, and assists all levels of management in making prudent financial decisions.

In order to meet these responsibilities, Financial Administration has organized itself around the following five service categories:

- System wide Accounting and Budget Control
- Shared Financial System Operations Management
- Financial and Administrative Policy Development
- Financial Analysis and Reporting
- System Administration Accounting and Budget Control

The *general objectives and constraints* under which these policies will be implemented are:

1. Financial control must be sufficient to maintain the integrity of the System's legal, budget, and reporting requirements.
2. Accounting operations should be decentralized to the greatest degree possible while maintaining an economical and effective accounting system.
3. Central Administration will be the single interface with the State Department of Administration for accounting purposes.

1.1 □ Conceptual Framework

I. Budgets and Allotments

The budget and the allotment establish the authority to receive and expend a given amount of resources. The budget represents an accepted plan to accomplish a set of goals with specified revenues and expenditures. The allotment process is the statutory action granting authority to the Board of Regents for the specific expenditures. Budget control will be exercised by Central/state Administration at the respective budgetary levels. Any of the following required adjustments to the printed annual operating budget must be reported to the respective authority.

1. Shifts between function and sub-function categories
2. Shifts between major object lines
3. Shifts between appropriations
4. Shifts between units
5. Shifts out of or into any unit level unassigned account
6. Increases or decreases in budget totals.

II. Revenues

Information concerning actual and unrealized income should be maintained and reported monthly for all funds by budgeted revenue categories as defined by the budget. Comparisons of current and periodic revenue projections with budget estimates of revenue are necessary for possible revision of expenditure budgets.

Each department/unit will be responsible for collecting, depositing and properly distributing all revenues/collections. Receipts will normally be deposited in local banks on a daily basis. In order to maximize interest earnings, revenue should be transmitted as soon as possible to the Treasury. The appropriate Central Administration personnel should have signature authority on all local banks for transferring funds to the Treasury. Distribution of the revenue to the proper classification should be made as soon as possible.

Each department/unit should maintain records for each budget revenue classification and send them to relevant authority in Administration.

III. Expenditures

To facilitate budget and allotment control of expenditures, an encumbrance accounting system will be utilized. Encumbrances will cover personnel costs as well as supplies and capital.

Financial Reporting for auxiliary enterprises shall be on an accrual accounting basis.

Disbursement of funds will be made after appropriate authorization and pre-audit, including verification that the specified funds are available at the various levels of control.

All departments/units will utilize a single system-wide accounting code structure. Each department/unit will be responsible for accumulation of its accounting data in accordance with the coding structure, and may accomplish it with its own facilities or through use of its respective central processing center.

Pre-audit - Each department/unit is responsible for determining that every expenditure it makes or recommends is in accordance with the Statutes and the policies of the organization/country. Further, departmental/unit approval must provide assurance that funds are available. Thus, a pre-audit function must be carried out at initial level.

In addition, Central Administration will perform pre-auditing on a sample basis to provide an additional independent verification that the proposed expenditure is proper.

Encumbrances - An encumbrance accounting system will be maintained for all funds. This may be accomplished at the departmental /unit level with its own facilities or at a central processing center.

IV Reconciliation

Each department/unit will be responsible for reconciling its revenues and expenditures with relevant Administration each month. Such reconciliation will be facilitated by the consistent handling by all units/departments.

V Reporting

Each operating department /unit shall be responsible for providing required monthly, interim, and annual financial reports to the relevant central administration. Auxiliary operations will report on a full accrual basis in accordance with the uniform reporting system already in existence. All other operations will be reported on a modified accrual basis. Reports from units may be required on a monthly, quarterly, semesterly, annual, or as-needed basis. Reports will be in accordance with the uniform accounting code and will include the level of detail as required by Department of Administration and/or Central. Monthly revenue and expenditure reports for Central Administration purposes will contain, as a minimum, the data of Prior Year and of Current Year with date.

In addition to the revenue and expenditure reporting, each department /unit will be responsible for developing a year-end balance sheet for its respective unit in accordance with the rules of financial administration and the audit guide as published by the respective Certified Public Authority.

1.2 □ Distinction between Public and Private Financial Administration and Understanding of the reality

1.2.1 Historical Context

History witnesses the evolution of the Nation-State in two phases:

- *transition from feudalism to the absolutist State*—Serfs reproduced via their own lots replaced slaves. They enjoyed relative freedom - but were bound to the land. The system could be managed without large scale military.
- *transition from the absolutist state to the liberal State*, followed by the rise of towns outside feudal order, chartered by King, ruled by Councils of

Burghers. Towns paid taxes directly to the Kings. Serfs who fled the manors found work in the cities. King used towns as power base - often abrogating the Laws of Return. Absolutist state required structural reform to replace the decentralized decision making of feudalism.

Evolution of modes of production from feudal to mercantile and then mercantile to capitalistic one necessitated the growth of a centralized state system with a uniform legal-structure. In course of time manufacture became more important. Guilds became non-aristocratic power structures. Growing urban population meant that agriculture had to be commercial. Trade began to open in the 14th century. King needed standing army. Taxation was needed to support standing army. Standing army could be used to suppress nobles.

The Rise of Absolutism and the Nation-State System could be attributed to the following events.

A. The Reformation and the Religious Wars

- 1517 Martin Luther in Wittenberg
- 1519-1531 Zwingli & Calvin
- 1533 Henry 8th - Divorce from Catherine of Aragon - Aunt of Chas V - of HRE

B. France and the Holy Roman Empire - MAP

- 1520 Charles V declared HRE - Defender of the Church in Austria, Hungary and German states.
- 1546-1547 Schmalkadan War - Protestant German Princes- revolt against the HRE - HRE wins
- 1552 Second Schmalkadan Uprising-this time supported by Henry II of France - German Princes wins
- 1555 Peace of Augsburg

1.	Princes of Germany can choose their religion between Lutheranism and Catholicism-but not Calvinism
2.	Cujus Regio, ejus Religio - "the religion of the prince is the religion of the people"
3.	Ecclesiastical Princes (bishops) lose their lands if they convert to Lutheranism.
4.	Protestant princes retain land won- Calvinism entered German States- contrary to the terms of Augsburg

1608 **Elector of Palantine proposed Evangelical Union** - to unite protestant states of HRI vs Hapsburgs Maximillian of Bavaria organized the Catholic League in opposition to Evangelical Union

C. **The thirty years war-1618-1648.** followed by the enactment of the **TREATY OF WESTPHALIA (1648)** The treaty marked the very first recognition of the secular state.

The 17th and 18th century saw the emergence of the "great powers" Europe.

- 1 Growth of Bureaucracy
- 2 Growth of Official Diplomacy - establishment of missions
- 3 Mercantilism
- 4 Empire Building - Mercantile Imperialism

During this period capitalism required that private investors must invest their money. Mercantilism was found anti-capitalist. Absolute state meant that investors had to get charter from monarchy. This idea had to be changed giving place to the ideals of liberalism:

- 1 Freedom of choice
- 2 Equality among at least some set of competitive elites
- 3 Laissez Faire economy - keep your hands off
- 4 Self regulating economy
- 5 Participation in policy making - DEMOCRACY
- 6 Primacy of property rights

The democratic ethic arose from liberalism which led to the rise of secularist politics [absolutist states] arising out of the philosophies of enlightenment followed by reformation in Europe. The idea of William of Occam (13th century) that freedom to pursue a personal relationship with God (Reformation) was emphasized. The notion of Enlightenment that the freedom to pursue knowledge outside of the Church - i.e., knowledge of the world, not constituted by God found significance. The value of freedom to constitute the political world separately from the religious was highlighted. The attribute of liberalism, the freedom to pursue individual interests without subordination to the state found expression. History again witnessed the outbreak of liberal revolutions:

1776- First liberal revolution in USA .

1789- French Revolution : French people overthrow their aristocracy.

1793- England forms coalition with Spain, Prussia and the Netherlands against France.

1795- Paris revolt put down by commander of Paris Brigade, Napoleon. Napoleon rewarded with Command of French Army in Italy.

- The Liberal States were formed on different parts of Europe.
- Now the Bourgeoisie had enfranchisement, there were reforms in the conditions of the working class; role of the Nobles was reduced-& eliminated;
- Interests of the states shifted from the "Passions" of the rulers to the "Interests" of the economy and its elite.

In early liberal democracies, it was accepted that "value-laden decisions are in the domain of politicians while public servants merely implement these decisions with no room to influence policy-choices."

The rise of the liberal state specifically entailed a sharpening of the public-private distinction: on the one hand, the privatizing of religious and moral belief and practice and of economic activity formerly regulated by the state; on the other, a commitment to public law and public political discussion. Classical liberalism is often represented as a purely privatizing ideology, but liberals were committed to suppressing markets in votes, offices, and tax collection, not to mention human beings. Strengthening the public character of the state is continuity in liberal thought from its classical to contemporary phases.

In course of time, with the changes in socio-economic scenario the concepts of police-state and laissez-faire economy suffered a setback. Challenges from different quarters evolved a newer concept of welfare state, where the state was expected to perform a more positive role through a variety of education, health and rural development programmes. In developing countries, the administration was desired to be more responsive to the popular demands.

Western developed countries since late 1970s have sought to introduce a policy of state-minimalism reducing the scope of bureaucratic interference in the process of development. State investment has been lowered, leaving a scope for the private sector to contribute in the course of development. This process of thought is not at all origin in the developing and under developed countries. The question of public choice is getting enormous importance in view of the fact that in this post-industrial phase, polity and economy is supposed to come closer to facilitate the process of growth.

Since 1980s, a view is emerging that similarities in public and private administration is greater than the differences. The private sector notion of doing simple things well according to the competitive advantage of the producer became the preferred strategy for improving the quality of public service is. Thus originates the basic notion of 'public choice', which is actually an attempt to apply the rules of economics in the study of politics and of public administration. The public choice theory challenges the traditionally established social utility services of a democratic-government. Public choice theorists argue that career bureaucracy neither can be responsive to societal welfare, nor can respond to market needs.

Bureaucratic excesses and bureaucratic inefficiency now have been found to be intolerable and therefore debureaucratization and decentralisation of the decision-making process are thought to be more convenient to deal with the variety and uncertainty.

From 1990s, instead of traditional public administration, new public management, better known as entrepreneurial government has come to dominate the field, aiming at efficiency, economy and effectiveness. The traditional bureaucratic hierarchy and centralisation of authority have now been subject to severe criticism, in the context of liberalisation and globalisation.

1.2.2 Transition From The Liberal State To The Entrepreneurial State

Administrative reform movements in American government are often characterized by the idea that government can or should be run like a business. This has resulted in repeated efforts to apply private sector business management practices to public administration. These reforms appear to assume that private and public organizations are similar and that management is generic. The practices of personnel administration and financial management are gaining popularity in public administration. Simultaneously private sector organizations are performing public sector work.

For most of this century, the idea that private sector management practices can be applied to government has been reflected in administrative reform efforts. Some reforms have been explicit attempts to "run the government like a business." Others have incorporated perceived businesslike practices into broader government reforms. Questions remain, however, about whether importing private sector practices into government can improve government performance. More fundamental uncertainties continue to exist

over the assumptions that underlie these management transplants. The questions are particularly relevant today as private sector-style management models dominate current government administrative reform efforts and market-based reforms introduce alternative ways to deliver government services.

Two areas of government management have consistently been identified as candidates for more businesslike management - personnel management and financial management. The rules-based, highly constrained, government-personnel-management, system is often cited as a target for businesslike reform to make it more flexible, empower its employees, and provide managers with greater authority to hire and fire. Motivating employees through pay for performance programs, perceived as commonplace and effective in the private sector, have been repeatedly promoted and attempted in the public sector. Public financial management is seen as too focused on budgets and appropriations, lacking private sector-type requirements for reliable financial reporting and record keeping. In addition to these internal government management reforms, the emergence of a strong privatization movement has introduced what may be the ultimate private sector-based reform: private organizations performing governmental functions.

1.2.3 Distinction Between Public & Private Administration

Noted management expert Drucker¹ examines three commonly held reasons why public service organization under-perform: managers are not "businesslike," the quality of their employees is low, and their objectives and results are too intangible. Six prescriptions are offered to improve performance: better definition of the organization's business, clear objectives and goals, priority setting, measure of performance, systemized feedback from the results, and an organized audit of objectives and results.

A typology of organizations includes four categories: private for-profit, private non-profit, private quasi-public, and public. Differences are defined by the sources of their support. These externalities create different values incentives, and constraints on management. Analysis of sectoral effects on management functions gives evidence that management is not generic. There

1. Drucker, Peter (1973). "Managing in the Public Service Institution." *The Public Interest* 33 (Fall): 43-60.

appear to be differences in how management operates between public and private for-profit organizations. The other two categories show intermediate differences.

Public administration could be the key to improve the quality of public organizations. Broader concepts of public administration go beyond government. The management values of public administration include not only efficiency and economy, but also citizenship, fairness, equity, justice, ethics, responsiveness and patriotism.

Gulick's classic paper describes the common elements of generic management. These became known as PODSCORB—planning, organizing, directing, staffing, coordinating, reporting and budgeting. They were long considered essential elements of management in all types of public and private organizations².

Economic approach to organizational theory emphasizes such elements as the contractual nature of organizations, markets vs. hierarchies, transaction costs, rationality of individual actions, and analysis based on economic methods. When applied to public bureaucracies, economic theory can address questions of public organizations vs. alternative arrangements, managerial control within the bureaucracy, and political control of bureaucratic agents. Implicit is a comparison of public and private sector organizational environments.

Taylor's testimony lays out the four principles of scientific management. The principles are based on developing information about the work to be performed, selecting and developing workers, organizing the work and the workers, and dividing the work between workers and management. The idea is to replace rules of thumb with scientific information and organized work, which later were applied in public administration³.

James Q. Wilson points out that the distinction lies in the fact that government is seen as driven by the constraints on the organization, not by its tasks. Government managers have limited incentives to use to motivate workers and they have less control over the inputs and mix of organizational resources than do private managers. Public managers must be concerned

2. Gulick, Luther (1937). "Notes on the Theory of Organization," in Jay M. Shafritz and Albert C. Hyde, (eds.) (1992). *Classics of Public Administration*, 3rd Edition. Pacific Grove: Brooks/Cole.
3. Taylor, Frederick (1929) "Scientific Management," in Jay M. Shafritz and Albert C. Hyde (eds.) (1992). *Classics of Public Administration*, 3rd Edition Pacific Grove: Brooks/Cole.

with issues of accountability and equity. There are few incentives or opportunities to achieve economic efficiency.

A dimensional view of the public-private dichotomy is proposed in Wilson's classic study of administration. He argues the similarity of public and private sector administration and he proposes the politics-administration dichotomy on which much of subsequent administrative study and reform has been based.

All organizations are public. Their degree of "publicness" is determined by the degree to which organizations are affected by political authority or dependent upon public resources. The question of publicness is seen as having consequences for attempts to transfer management technologies and for understanding employee motivation.

Barry Bozeman and Bretschneider Stuart offer the concept of "publicness" as the extent to which an organization is influenced by political authority., From this concept, a continuum can be created to replace the dichotomous choice between public and private organizations. This dimensional approach offers additional explanatory power to explorations of the differences between public and private organizations⁴.

Barry Bozeman and S. Loveless consider the expected differences between public and private sector organizations. Using questionnaires from an international sample of research organizations, the results indicate the enduring importance of sector status and find strong independent effects from the environment of public and private organizations. One sector is not found to be consistently more productive than the other, however⁵.

Stuart Bretschneider⁶ presents another functional comparison of public and private organizations. Sectoral differences are found in MIS operations, largely based on the more constrained environments of public organizations.

4. Bozeman, Barry, and Stuart Bretschneider (1994). "The 'Publicness Puzzle' in Organizational Theory: A Test of Alternative Explanations of Differences Between Public and Private Organizations." *Journal of Public Administration Research and Theory* 4 (2): 197-223.
5. Bozeman, Barry and Loveless, S (1987), "Sector Context and Performance: A Comparison of Industrial and government Research Units," *Administration and Society* 19 (August): 197 - 335.
6. Bretschneider, Stuart (1990). "Managing Information Systems in Public and Private Organizations An Empirical Test." *Public Administration Review* 50 (September-October): 536-545.

Public organizations are characterized by greater accountability, interdependence, and red tape. ("Red tape" is addressed in many of the works cited in this collection. Generally it is understood to be an organizational attribute characterized by "excessive, duplicative or unnecessary procedures" While usually considered a negative organizational trait, it can be considered with a neutral connotation or even, in some instances as a positive attribute of some types of organizations).

David Coursey and Barry Bozeman apply Bozeman's concept of "publicness" to an analysis of decision-making across a dimensional distribution of public and private organizations. Drawing on a survey of top executives, differences are found in participation in strategic decision-making and in the types of problems that public and private organizations address⁷.

Zhiyong Lan and Hal G. Rainey⁸ test hypotheses about the differences between public and private organizations, using a three-part typology that includes hybrid organizations. As expected, the survey responses of public managers indicate perceived greater degrees of rules, procedures, and constraints in public organizations. Contrary to expectations, however, public managers perceive greater clarity of goals and greater effectiveness in achieving those goals.

Rainey, Hal G., Robert Backoff and Charles H. Levine⁹ examine the proposition that public and private organizations are converging and that management is a generic process. A summary of the literature identifies consensus around environmental factors, organization-environment transactions, and internal structures and processes. Indications of important differences between public and private organizations are found.

Focusing on the experiences of business leaders who assume senior positions in the federal government, B. H. Ross concludes that the sectors are different, not just in matters of efficiency and rationality, but in the entire organizational milieu. Issues of public scrutiny, non-economic rationality,

7. Coursey, David and Barry Bozeman (1990). "Decision-Making in Public and Private Organizations: Test of Alternative Concepts of 'Publicness'." *Public Administration Review* 50 (September-October): 525-535.

8. Lan, Zhiyong and Hal G. Rainey (1992). "Goals, Rules, and Effectiveness in Public, Private, and Hybrid Organizations: More Evidence on Frequent Assertions About Differences." *Journal of Public Administration Research and Theory* 2 (January): 5-28.

9. Rainey, Hal G., Robert Backoff and Charles H. Levine (1976). "Comparing Public and Private Organizations," *Public Administration Review* 36 (March-April): 233-244.

complex hierarchies, and external interference dictate that the rules are different. The requirements for managerial success are different between the public and private sectors¹⁰.

Using a national sample of public, private and hybrid research laboratories, if one tests three conceptual frameworks for comparing public and private organizations, the results will show strong support for the core approach and the dimensional approach to the public/private question. The generic approach, which suggests little or no difference in the managerial attributes of public and private organizations, may not be supported by the findings.

The terms public and private are fundamental to the language of our law, politics, and social life, but they are the source of continual confusion. Many things seem to be public and private at the same time in varying degrees or in different ways: quasi-public or semi-private. In fact, private is contrasted with public to characterize that, which lies beyond the state's boundaries, such as the market or the family. These different contrasts between public and private lead to some apparent conflicts in defining what lies on each side of the boundary. One such conflict concerns the location of the market. To an economist, the marketplace is quintessentially private. But to a sociologist or anthropologist concerned with culture, the marketplace is quintessentially public—a sphere open to utter strangers who nonetheless are able to understand the same rules and gestures in what may be a highly ritualized process of exchange. While economists use the public-private distinction to signify the contrast between state and market, analysts of culture—particularly those concerned with the roles and relations of men and women—take the public sphere to include the market as well as politics and contrast them both with the private domain of the family. In this sense, the public-private distinction is sometimes taken to mark out the contested boundaries of the male and female—a usage that takes us back to the notion of the private as being more closed, more shielded from contact and view than the open encounters of public life.

From these varying uses of the categories come several contrasting conceptions of the public sphere. The public sphere may be conceived of as the open and visible—the sphere of public life, public theater, the public

10. Ross, Bernard H. (1988). "Public and Private Sectors: The Underlying Differences." *Management Review* 77 (May): 28-33.

marketplace, public sociability. The public sphere also may be conceived of as that which applies to the whole people or, as we say, the general public or the public at large, in which case the public may consist of an aggregate or a mass who have no direct contact or social relation—the very opposite of a sphere of sociability. Alternatively, the public sphere may be conceived specifically as the domain circumscribed by the state, although exactly where to draw the state's boundaries may be difficult indeed.

1.2.3.1 Distinction Between Public & Private Financial Administration In Terms of Approach

Private ownership and competitive markets are normally thought to go hand in hand, but the two issues of ownership and market structure are often separate. For the economist devoted to both, the question then arises as to which object of affection is more beloved: private ownership or competition. Here a difference of opinion appears among economists that corresponds to a preference for either privatization or liberalization. Those who believe that efficient performance depends on private ownership per se favor privatization, even in cases generally regarded as natural monopolies. Conversely, those who see competition as the critical spur to efficiency are more skeptical about the benefits of privatizing monopolies and often put more emphasis on other policies, such as deregulation. In the case of a government telecommunications monopoly, for example, those who stress ownership may be willing to privatize the monopoly intact, whereas those who stress competition may prefer to break it up before sale or even to keep it in public ownership while allowing private firms to compete with it on equal terms.

□ Property Rights School

Like other branches of microeconomics, the *property rights school* conceives of human action as purely individualistic. The more individuals stand to gain from tending to their property, the better will it be tended. Conversely, the more attenuated and diluted their property rights, the less motivated individuals will be to use property under their control efficiently. Private ownership concentrates rights and rewards; public ownership dilutes them. The property rights school does not recognize any fundamental change in the working of private enterprise as a result of the separation of ownership and management in the modern corporation. To be sure, shareholders in

large corporations cannot monitor management as closely as the owner of the classical firm could oversee his enterprise. However, in this view, the market generates the needed spur to prevent corporate management from dissipating value through excessive salaries or slack attention. If returns from the enterprise are low, shareholders will sell their stock and the price will be depressed. In the extreme case, the firm may be acquired by outsiders and the managers may lose their jobs. These crucial deterrents to inefficient management are missing from the public sector. Since "shareholders" (citizens) have no transferable property rights in public enterprise, they cannot sell stock as a signal of dissatisfaction with performance; even moving to another jurisdiction is costly. Moreover, there is no "market for corporate control": public enterprises cannot be taken over by bidders who believe that they can make more efficient use of the assets. Hence, according to the theory, there is no check on the dissipation of value by the management of public enterprises.

First, the theory holds that the form of ownership is the predominant explanation for the varying performance of different organizations.

The theory gives no importance to organizational characteristics such as size, centralization, hierarchy, or leadership, nor does it recognize any variation in performance.

The theory does not even recognize the effects of economic incentives unrelated to property rights, such as those originating in various types of contracts.

The theory does not point to any contingencies in generalizing about public-private differences; it does not identify any particular conditions or characteristics that might cause public institutions to perform well. The disease the theory diagnoses in the public sector is, so to speak, genetic and incurable.

Second, the theory takes the market as the standard for judging value and finds public institutions deficient because they fail to measure up to that standard, e.g., their "shareholders" cannot sell stock. Survival in the market, of course, depends on the capacity of organizations to produce a residual reward for the owners—a profit. This is not the standard that public institutions generally need to meet.

Third, the property rights theory assumes that the market for corporate control is highly efficient and that the chief reason corporations are acquired is their management's poor performance. The theory gives no weight at all to the monitoring capacities of the state, the public at large, and the various

institutions of a liberal democracy, such as the press, that routinely scrutinize the performance of public institutions.

□ Public Choice Theory

"Public choice" though it only recognizes essentially private choice, is both a branch of microeconomics and an ideologically haded view of democratic politics. Analysts of the school apply the logic of microeconomics to politics. Budget maximization results in higher government spending overall, inefficient allocation among government agencies, and inefficient production within them. In addition, when government agencies give out grants, the potential grantees expend resources in lobbying up to the value of the grants.

Public choice school makes a series of empirical claims:

- (1) that democratic polities have inherent tendencies toward government growth and excessive budgets;
- (2) that expenditure growth is due to self-interested coalitions of voters, politicians, and bureaucrats; and
- (3) that public enterprises necessarily perform less efficiently than private enterprises.

□ Privatization as Community Empowerment

The view of privatization as community empowerment stands in sharp contrast to the conception of privatization as an extension of property rights. Peter Berger and Richard Neuhaus emphatically reject a narrowly individualistic view of human motivation. Indeed, they criticize liberalism precisely for defending individual rights over the rights of social groups to assert their own values. Their concern is not to expand the domain of the profit motive but rather to strengthen local, small-scale forms of social provision. This is privatization with a human face, and it bears some resemblance to left-wing interest in community organizations and cooperatives.

1.2.4 Blurring of the Distinction

Observers have concluded that many in the field now reject the traditional bureaucratic paradigm. Moreover economics seems much more

directly relevant to the concerns of public administration than in the recent past. There are few related reasons for these changes, like changes in the environment of public administration, and advances in economic science etc.

Changes in the Environment of Public Administration

Public administration in the United States has been influenced by the "new public management". The new public management emphasizes "performance appraisal and efficiency; the disaggregation of public bureaucracies into agencies which deal with each other on a user-pay basis; the use of quasi-markets and contracting out to foster competition; cost-cutting; and a style of management which emphasizes amongst other things, output targets, limited term contracts, monetary targets and incentives, and freedom to manage".

The new public management is a universal movement. Arguably, it represents a paradigm shift in public administration. Herman Schwartz, for example, claims that government is undergoing "a profound shift toward a new kind of regime ... not simply a shift towards less state, but also a shift to a different kind of state." He attributes this shift to international market pressures. He stresses that many of the governments that have embraced the new public management are or were dominated by social democrats¹¹.

The driving force behind the new public management is technological change. Reductions in information costs brought about by computers and computer networks and our increased capacity to use them have caused four major shifts in the comparative advantage of governance mechanisms and institutional arrangements.

1. The efficacy of the market has increased relative to government provision and control;
2. The efficacy of the market and other self-organizing systems has increased relative to hierarchically coordinated systems;
3. The efficacy of decentralized allocation of resources and after-the-fact control has increased relative to centralized allocation and before-the-fact control; and
4. The efficacy of process-oriented structures has increased relative to functional structures.

11. Schwartz, H. "Small States in Big Trouble," *World Politics*, 46/4 [July 1994], 527-555.

The computer is rapidly eroding economies of scale in administration, production, and marketing and, thereby, the comparative advantage of hierarchy and bureaucracy. Today, any organization that can afford a computer workstation and software can have first-class administrative systems, ranging from purchasing and inventory control to human resources management to financial planning and capital budgeting to marketing and logistics. Twenty years ago these systems were available only to giant organizations. Moreover, computerized production [which consists of machine tools or other equipment for fabrication, assembly or treatment, linked by a materials handling system to move parts from one work station to another, and operating as an integrated system under full programmable control] now permits organizations to produce customized services at mass-production prices.

In computerized production facilities, overheads are more important than production volume. In these facilities, direct manufacturing labor often accounts for less than 5 percent of costs; materials and purchased components typically account for thirty to forty percent more. This leaves (at least fifty-five) percent for overheads. Most overheads are transaction or information costs. They involve activities like purchasing, materials handling, marketing, accounting, and asset utilization. They are driven by an organization's policies, its operating and administrative procedures, and its customer relationships—not output volume, rate, or even mix.

□ Advances in Economics

Not only the business-management literature, but two bodies of economic literature have also profoundly influenced the reception and implementation of new public management: public choice theory and the new economics of organization. Public choice theory has changed the way we think about government and how it works. Moreover, in explaining the rules that voters, elected officials, and bureaucrats are likely to follow given their incentives, public choice theory has given public administrators some useful new normative information.

Module-I ● Unit 2 □ Public Choice Theory

Structure

- 2.0 Introduction
 - 2.1 Origins and formation
 - 2.2 Conceptual Framework
 - 2.3 Some other Aspects of Public Choice Theory
 - 2.4 Criticism
-

2.0 □ Introduction

Weberian conceptualisation of bureaucracy has dominated the public administration stream since its very beginning. To Weber, bureaucracy is the rational-legal authority, and hence most efficient, whereas the traditional (hereditary tribal chief) and charismatic (spontaneous leadership) authorities are primarily irrational and extra-legal. Weber suggested some very significant attributes of bureaucracy: fixed and official jurisdiction, hierarchy, written - facles training, full-time and permanent assignment, rule bindedness, discipline, impartiality. He laid stress on efficiency, precision, certainty, impersonality and neutrality.

Bureaucracy's strict adherence to the principles of hierarchy, specialisation and impartiality often is considered to be contrary to the democratic values of equality, participation.

In early liberal democracies the bureaucracy was assigned only a limited role, restraining itself only to the role of implementing the policies, predetermined by the political executives. It was accepted that value-laden decisions are in the domain of politicians while public servants merely implement these decisions with no room to influence policy-choices.

Since 1980s a view is emerging that similarities in public and private administration is greater than the differences. Richard Parry argued in this context that the preferred strategy for improving the quality of public service is the private sector notion of doing simple things well according to the competitive advantage of the producer.¹² Thus originates the basic notion of

12. Parry, Richard, Concepts and Assumptions of Public Management in Colis Duncan (ed.), *The Evolution of Public Management : Concepts and Techniques for the 1990s*, London, 1992.

'public choice', which is actually an attempt to apply the rules of economics in the study of politics and of public administration. The public choice theory challenges the traditionally established social utility services of a democratic government. Public choice theorists argue that career bureaucracy neither can be responsive to social welfare, nor can respond to market needs.

Bureaucratic excesses and bureaucratic inefficiency now have been found to be intolerable and therefore debureaucratisation and decentralisation of the decision-making process are thought to be more convenient to deal with the variety and uncertainty. It is the behaviour of public sector bureaucrats which is at the heart of public choice theory. While they are supposed to work in the public interest, putting into practice the policies of government as efficiently and effectively as possible, public choice theorists see bureaucrats as self-interested utility-maximizers, motivated by such factors as: "salary, prerequisites of the office, public reputation, power, patronage and the ease of managing the bureau" (Niskanen, W.A. *Bureaucracy: Servant or Master?* (London: Institute of Economic Affairs, 1973).

At the heart of all public choice theories then is the notion that an official at any level, be they in the public or private sector acts at least partly in his own self-interest, and some officials are motivated solely by their own self-interest. Broader motivations such as pride in performance, loyalty to a programme, department or government, and a wish to best serve their fellow citizens may also affect a bureaucrat. For Niskanen, self-interest is the sole motivator.

The chief proponents of this school are Duncan Black, Kenneth Arrow, M. Buchanan, Gordon Tullock, Vincent Ostrom. William Niskanen etc.

Dennis Mueller defines public choice approach as 'simply the application of economics to political science'. Its focus is on efficiency and rationality. The public choice theorists like Niskanen have argued that bureaucrats are always very keen to maximise their own departmental budget and to expand their scope of activities. Niskanen in his book *Bureaucracy and Representative Government*, argues that to raise the quality of performance of bureaucracy, it is required to reduce the monopoly of bureaucracy in supplying public goods and services. Increasing competition both within the bureau and outside in the market and change in the system of incentive can make the government effective. The politicians are merely power hungry. So they are actually interested in fostering narrow individual desires, instead of distributing public benefits. Therefore, public enterprises

should now be asked to lower their investment and to leave it to the private sector. Public sectors only increase expenditure and fail to maintain the quality of the work and products. The government should no longer exist as the 'doer of public activities, but should be the distributor of benefits and facilitator of change. Questioning the very efficacy of bureaucracy, Ostrom suggests that 'when the central problem in public administration is viewed as the provision of public goods and services, alternative forms of organisation may be available for the performance of those functions apart from an extension and perfection of bureaucratic structures. Bureaucratic structures are necessary but not sufficient structures for a productive and responsive public service economy.' Public choice theory introduces a competitive approach in the understanding of public administration. It advocates plurality in the institutional setup of providing public goods and services, the thing now being introduced in India, in the areas of air travel, telecom etc. The individual now has his choice as per his rationally designed self interest.

The basic assumption of public choice is that an individual actor, whether he is the manager or the consumer, is a utility maximiser, who will act in accordance with his self interest in order to maximise his net benefits. So a rational man selects the best course of action from among the available alternatives and he tries to minimise the amount of risk and uncertainty on the basis of relevant information remaining within the limits of lawful conducts.

Therefore, political action must be understood as the outcome of the actions of motivated atomistic individualism. For that the initial constitutional requirement is to construct the political institutions that will best suit the cause of individual liberty. The public choice theorists regard the notions of organic views of social and political organisation or that of "general will" or "public interest" as mystical, even they are not ready to accept marxist idea of class domination. Their primary concern is the utility-maximising individual. Niskanen is of the view that 'a better government would be a smaller government'.

Public choice theorists believe that each individual in search of maximising his net benefit, contribute to public good. For instance, defence, law and order fall in this category which individual would not like to disturb for the sake of his own interest.

Sometimes, public goods become private goods when they benefit only

a section. For example, industries are necessary for economic prosperity, but they may create pollution. The government is desired to regulate the process of industrialisation in a way to maximise the utility and minimise the undesirable effects, and thus to respond to consumer's demand. One may think of the resemblance of the theory to the conceptual framework suggested by early individualists. But main difference may be in the fact that along with outright privatisation drive, the responsible government may strive for regulating the private sector in a way to realise the value of sustainable development, instead of adhering to the path of traditional development.

Public choice theorists prefer decentralisation, democratisation and organisational competitiveness. It is not just people's easy access to governmental units, rather it creates opportunity for the individual to have a choice from among several political organisation, performing similar functions. Moreover, they hold that authority should be divided to limit arbitrary use of power by the government organs and to control their corruptibility. Ostrom observes in this connection that 'To stimulate healthy and democratic competition among government agencies, multi-organisational arrangements are better than monocentric administrative apparatus structured hierarchically'. Ostrom's individualistic, consumer-oriented organisational design was meant to maximise efficiency at least possible cost and resources. He mentions that 'Producer efficiency in the absence of consumer utility is without economic meaning.' So the need of the hour is to increase administrative effectiveness, as David Beetham viewec it and to ensure the quality of service at least possible cost To that extent Ostrom observes that administration cai never be indifferent to politics.

A field that is closely related to public choice is "*rent-seeking* " This field combines the study of a market econoimy with that of government. Thus, one might regard it as a "new political economy." Its basic thesis is that when both a market economy and government are present, government agents are a source of numerous special marke privileges. Both the government agents and self-interested market participants seek these privileges in order to partake in the monopoly rent that they provide. When such privileges are granted, they reduce the efficiency of the economic system. In addition, the rent-seekers use resources that could otherwise be used to produce goods that ar valued by consumers.

Rent-seeking is broader than Public Choice in that it applies to autocracies as well as democracies and, therefore, is not directly concerned

with collective decision-making. However, the obvious pressures it exerts on legislators, executives, bureaucrats, and even judges are factors that Public Choicers must account for in their effort to understand and assess collective decision-making rules and institutions. Moreover, the members of a collective who are planning a government would be wise to take prospective rent-seeking into account.

Public choice takes the same principles that economists use to analyze people's actions in the marketplace and applies them to people's actions in collective decision making. Economists who study behavior in the private marketplace assume that people are motivated mainly by self-interest. Although most people base some of their actions on their concern for others, the dominant motive in people's actions in the marketplace—whether they are employers, employees, or consumers—is a concern for themselves. Public choice economists make the same assumption—that although people acting in the political marketplace have some concern for others, their main motive, whether they are voters, politicians, lobbyists, or bureaucrats, is self-interest.

In the past many economists have argued that the way to rein in "market failures" such as monopolies is to introduce government action. But public choice economists point out that there also is such a thing as "government failure." That is, there are reasons why government intervention does not achieve the desired effect. For example, the Justice Department has responsibility for reducing monopoly power in noncompetitive industries. But a 1973 study by William F. Long, Richard Schramm, and Robert Tollison concluded that actual anti-competitive behavior played only a minor role in decisions by the Justice Department to bring antimonopoly suits. Instead, they found, the larger the industry, the more likely were firms in it to be sued. Similarly, Congress has frequently passed laws that are supposed to protect people against environmental pollution. But Robert Crandall has shown that congressional representatives from northern industrial states used the 1977 Clean Air Act amendments to reduce competition by curbing economic growth in the Sunbelt. The amendments required tighter emissions standards in undeveloped areas than in the more developed and more polluted areas, which tend to be in the East and Midwest.¹³

One of the chief underpinnings of public choice theory is the lack of

13. http://en.win\kipedia.org/wiki/public_choice_theory.

incentives for voters to monitor government effectively. Anthony Downs, in one of the earliest public choice books, *An Economic Theory of Democracy* pointed out that the voter is largely ignorant of political issues and that this ignorance is rational. Even though the result of an election may be very important, an individual's vote rarely decides an election. Thus, the direct impact of casting a well-informed vote is almost nil; the voter has virtually no chance to determine the outcome of the election. So spending time following the issues is not personally worthwhile for the voter. Evidence for this claim is found in the fact that public opinion polls consistently find that less than half of all voting-age Americans can name their own congressional representative.

Public choice economists point out that this incentive to be ignorant is rare in the private sector. Someone who buys a car typically wants to be well informed about the car he or she selects. That is because the car buyer's choice is decisive—he or she pays only for the one chosen. If the choice is wise, the buyer will benefit, if it is unwise, the buyer will suffer directly. Voting lacks that kind of direct result. Therefore, most voters are largely ignorant about the positions of the people for whom they vote. Except for a few highly publicized issues, they do not pay a lot of attention to what legislative bodies do, and even when they do pay attention, they have little incentive to gain the background knowledge and analytic skill needed to understand the issues.

Public choice economists also examine the actions of legislators. Although legislators are expected to pursue the "public interest," they make decisions on how to use other people's resources, not their own. Furthermore, these resources must be provided by taxpayers and by those hurt by regulations whether they want to provide them or not. Politicians may intend to spend taxpayer money wisely. Efficient decisions, however, will neither save their own money nor give them any proportion of the wealth they save for citizens. There is no direct reward for fighting powerful interest groups in order to confer benefits on a public that is not even aware of the benefits or of who conferred them. Thus, the incentives for good management in the public interest are weak. In contrast, interest groups are organized by people with very strong gains to be made from governmental action. They provide politicians with campaign funds and campaign workers. In return they receive at least the "ear" of the politician and often gain support for their goals.

In other words, because legislators have the power to tax and to extract

resources in other coercive ways, and because voters monitor their behavior poorly, legislators behave in ways that are costly to citizens. One technique analyzed by public choice is log rolling, or vote trading. An urban legislator votes to subsidize a rural water project in order to win another legislator's vote for a city housing subsidy. The two projects may be part of a single spending bill. Through such log rolling both legislators get what they want. And even though neither project uses resources efficiently, local voters know that their representative got something for them. They may not know that they are paying a pro-rata share of a bundle of inefficient projects! And the total expenditures may well be more than individual taxpayers would be willing to authorize if they were fully aware of what is going on.

Although public choice economists have focused mostly on analyzing government failure, they also have suggested ways to correct problems. For example, they argue that if government action is required, it should take place at the local level whenever possible. Because there are many local governments, and because people "vote with their feet," there is competition among local governments, as well as some experimentation. To streamline bureaucracies, Gordon Tullock and William Niskanen have recommended allowing several bureaus to supply the same service on the grounds that the resulting competition will improve efficiency. Forest economist Randal O'Toole recommends that the Forest Service charge hikers and backpackers more than token fees to use the forests. This, he argues, will lead Forest Service personnel to pay more attention to recreation and reduce logging in areas that are attractive to nature lovers. And Rodney Fort and John Baden have suggested the creation of a "predatory bureau" whose mission is to reduce the budgets of other agencies, with its income depending on its success.¹⁴

Public choice economists have also tried to develop rule changes that will reduce legislation that caters to special interests and leads to ever-expanding government expenditures. In the late eighties James C. Miller, a public choice scholar who headed the Office of Management and Budget during the Reagan Administration, helped pass the Gramm-Rudman law, which set a limit on annual spending and backed it with automatic cuts if the ceiling was not met. The law had at least a temporary effect in slowing spending. Support for term limits and for a line-item veto also reflects the

14. http://en.wikipedia.org/wiki/public_choice.

public choice view that additional legislative rules are needed to limit logrolling and the power of special interests. Public choice scholars, however, do not necessarily agree on the potential effectiveness of specific rules.¹⁵

Because of its skepticism about the supposedly benign nature of government, public choice is sometimes viewed as a conservative or libertarian branch of economics, as opposed to more "liberal" (that is, interventionist) wings such as Keynesian economics. This is partly correct. The emergence of public choice economics reflects dissatisfaction with the implicit assumption, held by Keynesians, among others, that government effectively corrects market failures.

But not all public choice economists are conservatives or libertarians. Mancur Olson¹⁶ is an important counter example. Olson is known in public choice for his path-breaking book *The Logic of Collective Action*, in which he pointed out that large interest groups have trouble gaining and maintaining the support of those who benefit from their lobbying. That is because it is easy for individuals to "free-ride" on the efforts of others if they benefit automatically from those efforts. That is why, Olson explained, nineteenth-century farmers' groups, which were organized to be political lobbying groups, also sold insurance and other services. These provided a direct incentive for the individual farmer to stay involved. (As the number of farmers has declined in recent decades, they have become more politically powerful, an observation that supports Olson's contention.)

More recently, Olson wrote *The Rise and Decline of Nations*, which concludes that Germany, and Japan thrived after World War II because the war destroyed the power of special interests to stifle entrepreneurship and economic exchange. But Olson still favors a strong government.

Many public choice economists take no political or ideological position. Some build formal mathematical models of voting strategies and apply game theory to understand how political conflicts are resolved. Economists at the California Institute of Technology, for example, have pointed out that "agenda-setting"—that is, identifying the options that voters choose from, and even specifying the order of voting on the options—can influence political outcomes. This explains the role of initiatives and referenda as ways for

15. Idem.

16. Olson, Mancur, Jr. *The Logic of Collective Action*, Cambridge: Harvard University Press, 1965.

voters to set agendas, opening up options that legislatures otherwise would ignore or vote down.

Some of these economists have developed a separate and quite mathematical discipline known as "social choice." Social choice traces its roots to early work by Nobel Prize-winning economist Kenneth Arrow. Arrow's 1951 book, *Social Choice and Individual Values*, attempted to figure out through logic whether people who have different goals can use voting to make collective decisions that please everyone. He concluded that they cannot, and thus his argument is called the "impossibility theorem."¹⁷

In addition to providing insight into how public decision making occurs today, public choice analyzes the rules that guide the collective decision-making process itself. These are the constitutional rules that are made before political activity gets underway. Consideration of these rules was the heart of *The Calculus of Consent*, by James Buchanan and Gordon Tullock, one of the classics of public choice.

Buchanan and Tullock began with the view that a collective decision that is truly just—that is, a decision in the public interest—would be one that all voters would support unanimously. While unanimity is largely unworkable in practice, the book effectively challenged the widespread assumption that majority decisions are inherently fair. The approach reflected in *The Calculus of Consent* has led to a further subdiscipline of public choice, "constitutional economics," which focuses exclusively on the rules that precede parliamentary or legislative decision making and limit the domain of government.

Public choice theory, like the older normative theory of public finance from which it evolved, starts with the demand for and the supply of collectively provided goods and services. With two exceptions, the theory of demand for a collectively provided good is identical to the theory of consumer demand for a private good. In both instances, demand reflects individual willingness and ability to pay to consume a good or service. Total demand for the service is, therefore, assumed to be a decreasing function of the price of the good, an increasing function of the price of the good, an increasing function of consumer income, and the size of the market for the good. The two differences between the theory of demand for a collectively provided

17. Arrow, Kenneth J., *Social Choice and Individual Values*, 1951.

good and the theory of consumer demand for a private good are that the quantity of service provided within a jurisdiction is determined by a political process, usually assumed to be some form of majority rule, and is necessarily uniform throughout the jurisdiction.

Hence, the quantity demanded of a collectively provided service will depend upon its price (P), the permanent income of the citizenry (Y), & population size (C) i.e. : $D_i = f [P_i, Y, C]$ D_i = The tastes and elasticities of the median voter.

e = the price elasticity of demand for good i ;

a = the income elasticity of demand for good i ; and

b = a value from 0 to 1, representing the degree of publicness of good i ¹⁸.

Public Choice Theory is directed toward the study of politics based on economic principles. Public choice theory attempts to look at governments from the perspective of the bureaucrats and politicians who compose them, and makes the assumption that they act based on Budget-maximizing model in a self-interested way for the purpose of maximizing their own economic benefits (e.g. their personal wealth). The most important contribution of **Public Choice Theory** is that it recognizes that politicians are motivated by self interest the theory aims to apply economic analysis (usually decision theory and game theory) to the political decision-making process in order to reveal certain systematic trends towards inefficient government policies. There are also Austrian variants of public choice theory (suggested by Mises, Hayek, Kirzner, and Boettke) in which it is assumed that bureaucrats and politicians are benevolent but have access to limited information. The assumption that such benevolent political agents possess limited information for making decisions often results in conclusions similar to those generated separately by means of the rational self-interest assumptions.

Positive public choice theory focuses on the question of what government policies are *likely* to be implemented in a given political setting, while normative public choice theory considers what policies *would* produce a desirable outcome if they were implemented.

Prior to the emergence of public choice theory, many economists tended

18. Borchertding, T.E. Budgets and Bureaucrats: The Sources of Government Growth. Durham, NC: Duke University Press [1977].

to consider the government as an agent outside the scope of economic theory, whose actions depend on different considerations than those driving economic agents. The many *other* economists who did place the state and its agents within such theory would include Vilfredo Pareto.

One of the basic claims that results from public choice theory is that good government policies in a democracy are an underprovided public good, because of the rational ignorance of the voters. Each voter is faced with a tiny probability that his vote will change the result of the elections, while gathering the relevant information necessary for a well-informed vote requires substantial time and effort. Therefore, the rational decision for each voter is to be generally ignorant of politics and perhaps even abstain from voting. Rational choice theorists claim that this explains the gross ignorance of most citizens in modern democracies as well as low voter turnout.

While good government tends to be a pure public good for the mass of voters, there may be many interest groups that have strong incentives for lobbying the government to implement specific inefficient policies that would benefit them at the expense of the general public. For example, lobbying by the sugar manufacturers might result in an inefficient subsidy for the production of sugar, either direct or by protectionist measures. The costs of such inefficient policy are dispersed over all citizens, and therefore unnoticeable to each individual. On the other hand, a small special-interest group with a strong incentive to perpetuate the policy by further lobbying shares the benefits. The vast majority of voters will be unaware of the effort due to rational ignorance. Therefore, theorists expect that numerous special interests will be able to successfully lobby for various inefficient policies. In public choice theory such scenarios of inefficient government policies are referred to as *government failure* — a term akin to *market failure* from earlier theoretical Welfare Economics.

From such results it is sometimes asserted that public choice theory has an anti-government tilt. But there is ideological diversity among public choice theorists. Mancur Olson for example was an advocate of strong government and instead opposed political interest group lobbying. More generally, James Buchanan has suggested that public choice theory be interpreted as "politics without romance," a critical approach to a pervasive earlier notion of idealized politics set against market failure. As such it is more a correction of the earlier scientific record almost requiring a certain pragmatism in comparing alternative politicized institutional structures (Buchanan 2003). The realization that

politicians and government employees are driven by self interest is an extremely seri conclusion.

2.1 □ Origins and Formation

The modern literature in Public Choice began with Duncan Black, who in 1948 identified the underlying concepts of what would become median voter theory. He also wrote *The Theory of Committees and Elections* (1958). Gordon Tullock refers to him as the "father of public choice theory."¹⁹ Public choice's application to government egulation was developed by George Stigler (1971) and Sam Peltzman (1976). William Niskanen is generally considered the founder of Public Choice literature on the *bureaucracy*. James Buchanan, (winner of the Nobel Prize on Economic Science, 1986, for work in Public Choice) and Gordon Tullock are credited with being the primary evelopers of Public Choice Theory.

The Calculus of Consent: Logical Foundations of Constitutional Democracy (1962), co-authored by James M. Buchanan and Gordon Tullock, of George Mason University, is considered one of the landmark works that founded he discipline of public choice theory. The book is about the political organization of a free society. However, its nethod, conceptual apparatus, and analytics are derived, essentially, from the discipline that has as its subject the economic organization of such a society. The book focuses on positive-economic analysis as to the development oi constitutional democracy but in an ethical context of consent in the sense of compensation for making a policy change and unanimity as a point of departure for social choice.²⁰

Kenneth Arrow's *Social Choice and Individual Values* (1951) influenced formulation of the theory. Among other important works are Anthony Downs's *An Economic Theory of Democracy* (1957) and Mancur Olson's *The Logio of Collective Action* (1965).

Development of Public Choice Theory accelerated with the formation of the Public Choice Society in the Unitec States in 1965. The journal *Public Choice* and society's annual meetings attracted economists and political scientists. The economists brought their choice-based, model-building skill.

19. Tullock, Gordon (1987), "public choice," *The New Palgrave: A Dictionary of Economics*, v. 3, pp. 1040-44.

20. Buchanan, James M. and Gordon Tullock. (1962), *The Calculus of Consent*. Ann Arbor: University of Michigan Press.

The political scientists brought their broad knowledge of different political systems and detailed knowledge of institutions and political interaction. Scholars in related fields, such as philosophy, public administration, and sociology, also contributed.

2.2 □ Conceptual Framework

Public Choice Theory is the use of modern economic tools to study problems of *constitutional democracy* traditionally the province of political science. In particular, it studies the behavior of voters, politicians, and government officials as (mostly) self-interested agents and their interactions in the social system either as such under alternative constitutional rules. These can be represented a number of ways, including standard constrained utility maximization, game theory, or decision theory. Public choice analysis has roots in positive analysis ("who is") but is used for normative purposes ("what ought to be") to identify a problem or suggest how a system could be improved by changes in constitutional rules. A key formulation of public choice theory is in terms of rational choice, the agent-based proportioning of scarce means to given ends. An overlapping formulation with a different focus is positive political theory. Another related field is social choice theory. Most public choice elements under Economic Models of Political Processes: Rent-Seeking, Elections, Legislatures, and Voting Behavior.

Prior to the emergence of public choice theory, many economists tended to consider the government as an agent outside the scope of economic theory, whose actions depend on different considerations than those driven by economic agents. Public choice theory attempts to look at governments from the perspective of the bureaucrats and politicians who compose them, and makes the assumption that they act based on a Budget-maximizing model in a self-interested way for the purpose of maximizing their own economic benefits (e.g. their personal wealth). The theory aims to apply economic analysis (usually decision theory and game theory) to the political decision-making process in order to reveal certain systematic trends towards inefficient government policies.

- to assess the effects of creating different loci of power and decision-making within a government;

- to examine voting and the various means of selecting candidates and choosing winners in elections;

to assess various behavioral rules that might be established to influence the behavior of elected and appointed government officials;

to evaluate alternative constitutional and legal rights that could be reserved for citizens, especially rights relating to citizen oversight and the avoidance of harm due to the coercive power of government agents.

Another major sub-field is the study of bureaucracy. The usual model depicts the top bureaucrats as being chosen by the chief executive and legislature, depending on whether the democratic system is presidential or parliamentary. The typical image of a bureau chief is a person on a fixed salary who is concerned with pleasing those who appointed him. The latter have the power to hire and fire him more or less at will. The bulk of the bureaucrats, however, are civil servants whose jobs and pay are protected by a civil service system against major changes by their appointed bureau chiefs. This image is often compared with that of a business owner whose profit varies with the success of production and sales, who aims to 'maximize profit, and who can hire and fire employees at will.

2.3 □ Some Other Aspects of Public Choice Theory

Constitutional, Democratic Government

Public Choice Theorists attempt to examine the system of government in which the people governed define their government by means of a constitution.

Voting

Much attention has been given in the Public Choice field to the problem of voting. The simple approaches currently used have been shown to be defective as they do not always achieve the desired results. Alternative voting methods are examined and evaluated. Unfortunately, it has been difficult to modify our voting methods to reflect this knowledge.

Political Manipulations

Public Choice scholars have looked at the ways politicians interact with each other, the voters, and their supporters to achieve their own goals. Vote-trading, "log-rolling", wealth transfers, etc. are a few of the methods they use to obtain their own selfish ends and, occasionally, the wants of the citizens.

Rent-Seeking

Public Choice has much to say about the use of rent seeking, which is the act of obtaining special treatment by the government at the expense of the rest of us.

Finally, Public Choice scholars examine the options involved with solving the many social dilemmas resulting from living in groups or collectives. We know that private enterprise is not a good solution to the problem of the distribution of public goods.

Criticism

The theory presents voters as narrowly self-interested. Voters, in other words, are capable of recognizing a collective interest apart from their own. Indeed, the whole point of "government by discussion" is to discover and express common interests not easily voiced or achieved in the private sphere. The public choice approach simply does not comprehend this preference-shaping function of political democracy.

It also neglects the restraints built into the architecture of liberalism. While the theory holds that government is systematically biased toward dissipating value and increasing expenditure, it disregards the checks and balances among branches of government and within them.

The rhetoric of the public choice school is a kind of hard-core realism. The theory dismisses as naive civic ideals such as public service; it denies the capacity of voters or politicians to act on the basis of a national interest wider than their own private aggrandizement. Rather like Marxism, public choice theory claims to face up to the self-interested basis of democratic politics and therefore treats all claims of higher purpose as smoke and deception. And also like Marxism, the theory presents itself as a scientific advance over earlier romantic and idealized views of the state. But rather than being an advance of science over intuition, the appeal of the public choice school is precisely to those who are intuitively certain that whatever government does, the private sector can do better. Together, the property rights and public choice schools show only that, if you start by assuming a purely individualistic model of human behavior and treat politics as if it were a pale imitation of the market, democracy will, indeed, make no sense²¹.

21. Jane S. Shaw's article on Public Choice Theory at the Concise Encyclopedia of Economics site.

Module 1 ● Unit-3 □ Implications of Financial Administration

Structure

- 3.1 Subsidy
 - 3.1.1 Types of subsidies
 - 3.2 Downsizing
 - 3.3 Safety
 - 3.3.1 Types of safety
 - 3.4 Reference
 - 3.5 Exercises
-

3.1 □ Subsidy

In standard supply and demand curve diagrams, a subsidy will shift either the demand curve up or the supply curve down. A subsidy that increases production will result in a lower price while a subsidy that increases demand will tend to result in an increase in price. Both cases result in a new Economic equilibrium. Therefore, it is essential to consider elasticity when estimating the total costs of a planned subsidy: it equals the subsidy per unit (difference between market price and subsidized price) times the new equilibrium quantity. One category of goods suffers less from this effect: Public goods are - once created — in ample supply and the total costs of subsidies remain constant regardless of the number of consumers; depending on the form of the subsidy, however, the number of producers demanding their share of benefits may still rise and drive costs up.

The recipient of the subsidy may need to be distinguished from the beneficiary of the subsidy, and this analysis will depend on elasticity of supply and demand as well as other factors. For example, a subsidy for consumption of milk by consumers may appear to benefit consumers (or some subset of consumers, such as low-income households); but if supply of milk is constrained and results in higher demand and higher prices, the milk producer may benefit and the consumer may derive no net gain, as the higher prices for milk offset the subsidy.

The net effect and identification of winners and losers is rarely straightforward, but subsidies generally result in a transfer of wealth from one group to another (or transfer between sub-groups).

Subsidy may also be used to refer to government actions which limit

competition or raise the prices at which producers could sell their products, for example, by means of tariff protection. Although economics generally holds that subsidies may distort the market and produce inefficiencies, there are a number of recognized cases where subsidies may be the most efficient solution.

In many instances, economics may (somewhat counter-intuitively) suggest that direct subsidies are *preferable* to other forms of support, such as hidden subsidies or trade barriers; although subsidies may be inefficient, they are often less inefficient than other policy tools used to benefit certain groups. Direct subsidies may also be more transparent, which may allow the political process more opportunity to eliminate wasteful hidden subsidies. This problem - that hidden subsidies are more inefficient, but often favored precisely because they are non-transparent - is central to the political-economy of subsidies.

Examples of industries or sectors where subsidies are often found include utilities, gasoline in the United States, welfare, farm subsidies, and (in some countries) certain aspects of student loans.

3.1.1 Types of subsidies

There are many different ways to classify subsidies, such as, the reason behind them, the recipients of the subsidy, the source of the funds (government, consumer, general tax revenues, etc). In economics, one of the primary ways to classify subsidies is the means of distributing the subsidy.

In economics, the term subsidy may or may not have a negative connotation: that is, the use of the term may not be prescriptive but descriptive. In economics, a subsidy may nonetheless be characterized as inefficient relative to no subsidies; inefficient relative to other means of producing the same results; "second-best", implying an inefficient but feasible solution (contrasted with an efficient but not feasible ideal), among other possible terminology. In other cases, a subsidy may be an efficient means of correcting a market failure.

For example, economic analysis may suggest that direct subsidies (cash benefits) would be more efficient than indirect subsidies (such as trade barriers); this does not necessarily imply that direct subsidies are good, but that they may be more efficient or effective than other mechanisms to achieve the same (or better) results.

Insofar as they are inefficient, however, subsidies would generally be

considered by economists to be bad, as economics is the study of efficient use of limited resources. Ultimately, however, the choice to enact a subsidy is a political choice. Note that subsidies are linked to the concept of economic transfers from one group to another.

Economics has also explicitly identified a number of areas where subsidies are entirely justified by economics, particularly in the area of provision of public goods.

● Direct subsidies

Direct subsidies are the most simple, and arguably the least frequently used. They involve a direct cash transfer to the recipient, for example an unemployed person through Employment Exchange like organizations or through district administration or an agricultural cooperative.

● Indirect Subsidies

Indirect subsidy is a term sufficiently broad that it may cover most other forms of subsidy. The term would cover any form of subsidy that does not involve a direct transfer.

● Labour/Gender subsidies

A labor subsidy is any form of subsidy where the recipients receive subsidies to pay for labour costs. Examples may include labour subsidies and tax deductions for workers in industries, such as the film and television industries. Women are given Income Tax benefit in the form of special subsidy in the standard deduction.

● Tax Subsidy

Tax subsidy is any form of subsidy where the recipients receive the benefit through the tax system, usually, through the income tax, profit tax, or consumption tax systems. Examples may include tax deductions for workers in certain industries, accelerated depreciation for certain industries or types of equipment, or exemption from consumption tax (sales tax or value added tax).

● Production subsidies

In certain cases (to encourage the development of a particular industry, for example), governments may provide production subsidies - cash payments

for production of a given good or service. Frequently, production "subsidies are less easily identifiable, such as minimum price policies. Indirect production subsidies may be less easy to identify, such as infrastructure subsidies.

● Infrastructure subsidies

Infrastructure subsidies may be used to refer to a form of indirect production subsidy, whereby the provision of infrastructure (at public expense) may effectively be useful for only a limited group of potential users, such as construction of roads at government expense for a single logging company. The implication is that those users industries benefit disproportionately from the provision of that infrastructure, at the expense of taxpayers.

In some cases, the "subsidy" may refer to favoring one type of production or consumption over another, effectively reducing the competitiveness or retarding the development of potential substitutes. For example, it has been argued that the use of petroleum, and particularly gasoline, has been "subsidized" or favored by U.S. defense policy, reducing the use of alternative energy sources and delaying their commercial development.

● Trade protection (Import)

Measures used to limit imports from other countries may constitute another form of hidden subsidy(policy adopted for importing Hilsa fish from Bangladesh). The economic argument is that consumers of a given product are forced to pay higher prices for a given good than they would pay without the trade barrier; the protected industry has effectively received a subsidy. Such measures include import quotas, import tariffs, import bans, and others.

● Export subsidies (Trade Promotion)

Various tax or other measures may be used to promote exports that constitute subsidies to the industries favored. In other cases, tax measures may be used to ensure that exports are treated "fairly" under the tax system. The determination of what constitutes a subsidy (or the size of that subsidy) may be complex. In many cases, export subsidies are justified as a means of

compensating for the subsidies or protections provided by a foreign state to its own producers.

● Procurement subsidies

Governments everywhere are relatively large consumers of various goods and services. Subsidies may occur in this process by choice of the products consumed, the producer, the nature of the product itself, and by other means, including payment of higher-than-market prices for goods purchased.

● Consumption subsidies

Governments everywhere provide consumption subsidies in a number of ways: by actually giving away a good or service, providing use of government assets, property, or services at lower than the cost of provision, or by providing economic incentives (cash subsidies) to purchase or use such goods. In India, especially in West Bengal, consumption of education, health care, and infrastructure (such as roads) are heavily subsidized, and many cases provided free of charge, at least few years back.

The provision of true public goods through consumption subsidies is an example of a type of subsidy that economics may recognize as efficient. In other cases, such subsidies may be reasonable second-best solutions; for example, while it may be theoretically efficient to charge for all use of public roads, in practice, the cost of implementing a system to charge for such use may be unworkable or unjustified.

In other cases, consumption subsidies may be targeted at a specific group of users, such as large utilities, residential home-owners, and others.

3.2 □ Downsizing

Downsizing is a word we've heard quite frequently in the past several years. It has taken on a meaning of its own, and it is a word that strikes fear and anxiety in the minds of many American employees. That's true not only in industry but also in government, utilities, public schools, universities and even in the military.

Like most other business phenomena, downsizing has both positive and negative attributes. When an organization gets "bloated", over-staffed, and non-competitive, or if the market place changes dramatically, a reduction

in staff may be necessary for the health and often the very survival of that organization. Obviously, such downsizing is painful to those who are the casualties. There are many other pressures that can lead to downsizing. One of the most pervasive and fundamental pressures is new technology. Computerization and advances in automation cause the elimination or reduction of certain types of jobs. Another has been the switch to a global economy. Think back twenty or thirty years and remember the state of communications, transportation, computers, entertainment, home electronics, medicine, education, government regulation, foreign competition, and the fabric of our society. The changes are dramatic, and they exert part of the downsizing pressure.

Such downsizing pressures as these are virtually inevitable, and they are for the most part healthy. They are a natural result of change. Industrial societies have had to adapt to such change for the past 150 years, but the rate of change today is staggering. Responding to such change is a real challenge for all of us.

There are other pressures as well. Downsizing raises the promise of profit growth, although sometimes this proves to be short term or illusory. The stock market exerts its own pressure. Companies that have announced plans to downsize have often seen their stock prices rise on the market. Executives who have a strong stake in a stock price rise, and most do, are given another reason to look toward downsizing in a positive light. For the same reason, stockholders often pressure management to downsize.

The effect of downsizing on employees, and often on whole towns or cities, can be devastating. The effects of those "downsized" out the door are fairly obvious- loss of income and self-esteem, the need to seek new employment, and an uncertain future.

3.3 □ Safety

Safety is the state of being "safe", the condition of being protected against physical, social, spiritual, financial, political, emotional, occupational, psychological, educational or other types or consequences of failure, damage, /error, accidents, harm or any other event which could be considered non-desirable. This can take the form of being protected from the event or from exposure to something that causes health or economical losses. It can include protection of people or of possessions.

There also are two slightly different meanings of *safety*, for example, a *safety* home may indicate its protection ability against external harm events, and the second that its internal installations are safe (not danger/harmful) its habitants. Safety can be limited in relation to some guarantee or a standard of insurance to the quality and anharmful function of an object or organization. It is used in order to ensure that the object or organization will do only what it is meant to do.

3.3.1 Types of Safety

It is important to distinguish between products that meet standards, that are safe, and those that merely feel safe. The highway safety community uses these terms:

Normative safety is a term used to describe products or designs that meet applicable design standards.

Substantive safety means that the real-world safety history is favorable, whether or not standards are met.

Perceived safety refers to the level of comfort of users. For example, traffic signals are perceived as safe, yet under some circumstances, they can increase traffic crashes at an intersection. Traffic roundabouts have a generally favorable safety record, yet often make drivers nervous.

Safety is often seen as one of a group of related disciplines: quality, reliability, availability, maintainability and safety. (Availability is sometimes not mentioned, on the principle that it is a simple function of reliability and maintainability.) These issues tend to determine the value of any work, and deficits in any of these areas are considered to result in a cost, beyond the cost of addressing the area in the first place; good management is then expected to minimize total cost were not politically prepared for taking pan in the elections. This network were mean! to build ihe capacity of the women and prepared them for the role they opted alter the elections. The Women Councilors Network held four training programs annually on different aspects of local bodies and the roie of the women councilors.

Minority Councilors' Network:

Human Development Centre is working in Toba Tek Singh. It works for the development of the people. It organizes people on community level. It works for the betterment of women, children, youth and workers in the society. It works to educate and to get aware people so that they could form

prosperous and peaceful society. It uses different ways for the mobilization of people like it organizes meetings, seminars, training, workshop and theatres on different issues.

A Minority Councilors Network is established in three districts of Toba Tek Singh, Jhang and Faisalabad with the following objectives:

1. Ensure equal citizenship rights for all in Pakistan
2. Build the capacity of the local minority councilors on development, issues, democratic culture and values
3. Promote the social harmony and national integrity in the country
4. Promote and strengthen the democratic institutions from the local government institutions to parliament

The minority councilors' network works to promote the values of love, peace, respect, forgiveness, reconciliation in the society. Human Development Centre plans to extend the scope of the Minority Councilors Network.

Devolution of Power plan brings more than 36,000 women in power in the local councils.

Women's Empowerment Issues in India

Gender discrimination continues to be an enormous problem within Indian society. Traditional patriarchal norms have relegated women to secondary status within the household and workplace. This drastically affects women's health, financial status, education, and political involvement. Women are commonly married young, quickly become mothers, and are then burdened by stringent domestic and financial responsibilities. They are frequently malnourished since women typically are the last member of a household to eat and the last to receive medical attention. Additionally, only 54 percent of Indian women are literate as compared to 76 percent of men. Women receive little schooling and also suffer from unfair and biased inheritance and divorce laws. These laws prevent women from accumulating substantial financial assets, making it difficult for women to establish their own security and autonomy. Kolkata Socio Cultural Research Institute (a voluntary women's organization) highlights following objectives towards women's empowerment:

- To undertake and promote socio economic and legal justice for women of all section with a special emphasis on backward section of the women.
- To be at the service of the aged, sick helpless and destitute widow and distressed women.

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- "[http://en.wikipedia.org/wiki/Public choice theory](http://en.wikipedia.org/wiki/Public_choice_theory)"

3.5. □ Exercises

1. Discuss the nature and significance of financial administration?
2. Point out the main criteria for distinguishing public and private financial administration?
3. Examine the tenets of public financial administration.
4. Write a critical note on neo-liberal approach to public financial administration.
5. Write a critical note on Public Choice theory and show its impact on public financial administration.

Module-II ● Unit-1 □ Budget : Concept-Evolution

Structure

- 1.0 Introduction
- 1.1 Concept, Evolutionan & Budget as a Tool for Administrative Efficiency
- 1.2 Preparation of Budget and role of Finacee Ministry
 - 1.2.1 Ministry of Finance
- 1.3 Buget in Some Countries
 - 1.3.1 United Kingdom
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 - 1.3.3.1 The role Parliament in Financial Accountability and Management in India
 - 1.3.3.2 Votes on Account
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- 1.4 Deficit Financing
 - 1.4.1 Fiscal Deficit
 - 1.4.2 Revenue Deficit
 - 1.4.3 Budgetary Deficit

1.0 □ Introduction

The word 'Budget' originally meant a bag, pouch or pocket attached to a person. In public administration, the term refers to a financial document which is annually placed before the legislature by the executive, giving a complete statement regarding the government revenues and expenditure of the past financial year and an estimate of the same for the next financial year.

There is no unanimity among writers regarding the definition of the term 'budget'. It has been defined differently by different authors of public administration. The word has been used synonymously with 'programming' and 'management'. However, most people agree that the budget is the keystone of financial administration and the various operations in the field of public finance are correlated through the instrument of the budget.

A budget is a financial report of statement and proposals, which are periodically placed before the legislature for its approval and sanction. A budget is a balance estimate for expenditure and receipts for a given period of time. In the hands of the administrator the budget is a record of past performance, a method of current control, and a projection of future plans. It is a report of the entire financial operations of the government of the past (for a given period) and gives us a glimpse into future government policy.

A government budget is a legal document that is often passed by the legislature, and approved by the chief executive. For example, only certain types of revenue may be imposed and collected. Property tax is frequently the basis for local revenues, while sales tax may be the basis for state revenues, and income tax and corporate tax are the basis for national revenues.

The two basic elements of a budget are the revenues and expenses. Budgets have an economic, political and technical basis. Unlike a pure economic budget, they are not entirely designed to allocate scarce resources for the best economic use. They also have a political basis wherein different interests push and pull in an attempt to obtain benefits and avoid burdens. The technical element is the forecast of the likely levels of revenues and expenses.

Budgeting aims to gather legislative support for government proposals. It is an attempt to allocate financial resources through political processes. It reflects an organization's goal and aspirations and its policies and proposals to realize them. The real significance of the budget lies in providing for the orderly administration of the financial affairs of a government.

Since the annual budget is almost without exception the main instrument of fiscal policy, the budget process and the information contained in and presented with the budget is central to fiscal transparency. Budget preparation and execution should be open in the sense that information is readily available on how budgets are prepared and executed (e.g., budget circulars and information on the budget process should be available to the public), though not exactly the participation of civil society in budget

processes. Further openness does not imply full disclosure to the public at all stages of the budget process. Transparency in this context is limited by considerations of market sensitivity, due process in policy formulation, and the costs of providing information to the public relative to the expected benefits.

Governments need the space for careful deliberation and decision-making before they expose the full detail of the proposed budget for legislative and public consideration. This is particularly important for tax policy changes. In general, however, the detailed budget proposals should be presented to the legislature in sufficient time to allow careful deliberation before passage of the necessary legislation. Principles and practices relating to openness of the budget process concern budget documentation, budget presentation, procedures for budget execution, and fiscal reporting.

1.1 □ Concept, Evolutionan & Budget As A Tool For Administrative Efficiency

While the budget has an annual perspective, it should be placed in a wider context. It is important to make a clear Statement about the broad objectives of fiscal policy and the sustainability of fiscal policy over the longer term. At the very least, it should be indicated in the budget documentation how the annual central government budget fits in with the government's broader objectives regarding government or public sector finances, and longer-term deficit and debt targets. This could be a mainly qualitative statement supported by a few key figures, in which case it could be included in the preamble to the annual budget or the budget speech. However, such statements are more helpful if they include quantitative detail on government or public sector finances and the longer-term fiscal outlook, in which case this information should be provided in a background paper that is part of the budget documentation.

- The budget documentation should specify fiscal policy objectives, the macroeconomic framework, the policy basis for the budget, and identifiable major fiscal risks.
- A statement of fiscal policy objectives and an assessment of fiscal sustainability should provide the framework for the annual budget.
- The annual budget should be prepared and presented within

a comprehensive and consistent quantitative macroeconomic framework, and the main assumptions underlying the budget should be provided.

- Any fiscal rules that have been adopted (e.g., a balanced budget requirement or borrowing limits for regional levels of government) should be clearly specified.

This is a basic requirement of fiscal transparency. As part of the broader context in which fiscal policy must be placed, its aggregate impact on the economy and its relation to other macroeconomic policies is critical. Most countries have some formal methodology for macroeconomic forecasting and policy formulation, and advanced economies use sophisticated quantitative models to help frame the budget. Information on the macroeconomic framework should be provided in a background paper that is part of the budget documentation. This may be combined with the discussion of fiscal policy objectives and fiscal sustainability in a fiscal and economic outlook paper, in which context the macroeconomic framework should be extended to support fiscal sustainability analysis.

Medium-term Budget Frameworks

Many countries already present basic fiscal and economic policy statements. Medium-term budget frameworks are administratively and politically demanding, and have been implemented mainly in advanced economies. However, some other countries have successfully implemented them. An important advantage of a medium-term budget framework for developing countries and countries in transition is that it helps link the capital and current budgets. Without the Fiscal rules are forms of agreement (usually in law) that restrict the fiscal policy action of government. Examples are a balanced budget requirement, borrowing limits for the central government or regional levels of government, a rule that public borrowing cannot exceed public investment. Obviously, if a fiscal rule is to be durable, there must be some flexibility in its application when a departure from the rule is justified by economic conditions. However, the circumstances under which such a departure is justified should be clearly explained.

While all countries should provide some indication of the sustainability of fiscal policy, more formal fiscal sustainability analysis would be a demanding requirement for many countries, especially since there are no clear and practical rules for establishing whether fiscal policy is sustainable

or not. Fiscal policies are unsustainable if they lead to a build-up of debt to an excessive level, in which case there is a need for change to current policy. However, judgments about excessive debt, and particularly about excessive debt-to-GDP ratios, are hard to make. Economic theory provides little guidance on this. A common approach, therefore, is to rely on a simple rule that specifies, for example, that the debt ratio cannot rise or cannot exceed a specific limit. But this and similar rules are arbitrary, and provide little guidance as to whether a particular debt ratio is a threat to macroeconomic stability, could lead to a loss of fiscal policy credibility, result in higher interest rate etc. Therefore assessments of fiscal sustainability have to be made on a country-specific basis, relying on particular knowledge about the implications of and market reactions to the government's past and future fiscal policies. In this connection, reporting a country's sovereign debt rating, and changes to the rating in recent years, provides one useful guide to sustainability. At a technical level, assessments of fiscal sustainability involve decomposing the change in the debt ratio into components reflecting the primary balance (overall balance excluding interest payments), the interest rate on debt, the growth rate of the economy, and the initial debt stock. This provides an indicator of the fiscal adjustment required for sustainability.

Macroeconomic Framework

For many developing countries and countries in transition, only an aggregate forecast will be feasible. This will nonetheless provide a useful starting point for considering medium-term changes in budget policy. Best practice is that a comprehensive, rolling medium-term budget framework (covering 3-5 years) should be published as a central basis of fiscal management.

A medium-term budget framework, if applied rigorously, provides a very clear statement of the revenue and expenditure effects of maintaining current government policies, and a mechanism for controlling the introduction of new policies and tracking budget implementation beyond a single year. It provides a transparent basis for accountability of the executive branch, and a necessary foundation for more detailed results-oriented budgeting. Medium-term budget frameworks have been used successfully by Germany, the United Kingdom, and Australia. Experience in these and other countries, however, suggests that stringent conditions have to be fulfilled before the full benefits can be attained.

The key characteristics of a medium-term framework are as follows:

- a statement of fiscal policy objectives,
- integrated medium-term macroeconomic and fiscal forecasts;
- estimates of expenditure and receipts of ministries and agencies for two to four years beyond the budget year;
- formal "forward" or "out-year" estimates—the first out-year estimate of expenditure becomes the basis of budget negotiations for the following year; and
- ministries' and agencies' budget appropriations become hard budget constraints.

The forward estimates process has significant technical advantages both for central agencies and individual spending agencies. For the latter, funding for their programs is given a greater degree of predictability, and the requirement for agencies to maintain multiyear estimates also provides greater clarity of policy at a program level. It should also be noted that, particularly in the United Kingdom and Australia, the establishment of a strong forward-estimates process has been associated with much greater flexibility for agencies in resource use within the aggregate and program ceilings. Nevertheless following principles must be the basis for such budget.

- fiscal policy objectives and quantitative fiscal targets need to be articulated and defended at the highest level of government;
- robust revenue forecasts are critical, and the target levels of expenditure must be rigorously related to the macroeconomic prospects over the medium term,
- budget and forward estimates are better set in nominal terms to ensure that program managers respond to price changes,
- the framework should be based on clearly defined policy proposals; and
- the medium-term budget framework should be accompanied by strengthened measures to review individual expenditure policies and their institutional delivery mechanisms.

Medium-term budget frameworks provide better, more transparent tools for formulating, assessing, and implementing fiscal policy, but they will only be effective if there is a real, stable, transparent, and well-publicized commitment to fiscal control. Medium-term budget frameworks must

also be based on fundamental institutional improvements, sustained political commitment, an appropriately phased introduction of improved forecasting, rigorous costing of programs, and disciplined budget management.

The budgetary system that evolved in England during the eighteenth and nineteenth centuries, was viewed primarily as a legal and accounting instrument, and the budget agency had the main responsibility of consolidating money estimates of the expenditure needs from the various departments each year. The conventional pattern of government budgeting serves the sole purpose of fiscal accountability and is merely a document for parliamentary control of the financial operations for the government. The entire expenditure is presented through a series of demands for grants. Every ministry presents one demand for its own requirements and separate demands for each of its subordinate organizations. The demands for grants thus follow the organizational pattern and the details in each of its demand are on the basis of object wise classification, for instance, establishment charges, contingencies equipment and materials. This type of budget is known as the line-item budget with its focus on itemized classification of expenditure.

The line item budget is effective from the viewpoint of public accountability, but today a budget has several other objectives viewed as an instrument of financial administration, budget is a vital tool of management. As an operational instrument, it is presented in the form of projects and programmes for which there is managerial responsibility in terms of achievement and cost in a given period. The government budget is being used as an instrument for analysing governmental policy in financial administration. It can be used to review the effects of the fiscal policy of government which has an impact on the national economy as a whole. Through the budgetary processes the government and capital investment consumption which practically affects all segments of the national economy and economic behaviour of the entire nation.

Traditionally, budgets have been mainly designed to ensure financial and legal accountability to the legislature and, within the executive, observance of similar accountability on the part of each subordinate agency. Budgets are generally prepared with emphasis on the subjects of expenditure constituting the primary units of appropriation such as salaries of officers, establishment charge, allowance honoraria, etc. They lay more emphasis on the cost aspects

without any indication of the results. The traditional budget reveals chiefly the purchase policy of government, not exactly what the government does. In short, traditional budgeting fails to provide an adequate link between financial outlays and physical targets. The four shortcomings in the conventional budget arise mainly from the existing systems of classification. Those are:

(a) The classification does not serve as an adequate base for informed decision making at each level of management. It does not help management to control and appraise the performance and

1.2 □ Preparation of Budget and Role of Finance Ministry

Preparation of the national budget requires discussion on following general steps -

- Budget notifications of the Minister of Finance.
- Policy letters from the ministries.
- Framework letter from the Minister of Finance Budget letters and budget memorandums.
- The preparation of the national budget and the Budget Memorandum.
- Submitting the preliminary draft budget.
- Final decisions on the budget in the Council of Ministers.

Budget Notifications Of The Minister Of Finance

The Minister of Finance sends a budget notification to the other ministers with technical and procedural directives which the specialist ministers must take into account in the preparation of their budget. It concerns inter alia procedural directives such as: when must the ministers submit the preliminary draft budgets to the Minister of Finance, but also the economic data affecting their expenditure. The intention of the budget notification is that all ministries base their budgets on the same premises.

Policy Letters From The Ministries

The directives from the budget notification of the Minister of Finance are internally transmitted within the ministries. The various departments of the ministries prepare their budget proposals. During the preparation the emphasis shifts to the policy contents. And thereby to the questions: what do

we wish to achieve, how will we go about it and how much can we spend? The results of the implementation of the budget of the current and previous year are thereby also taken into account. The proposals are submitted to the central department dealing with financial economic affairs of the individual ministries, which reviews them, comments on them and forwards them to the Minister and the Secretary/Secretaries. The political heads decide which priorities must be given, on which issues more money must be spent, on which less and for which policy additional funds may be requested. This is laid down in a policy letter sent to the Minister of Finance.

Framework Letter From The Minister Of Finance

The Ministry of Finance uses the information from the policy letters to prepare a summary of the windfalls and setbacks and of the claims for the desired new policy. On the basis of this summary and the recent economic insights (data from the Central Planning Office on the economic developments, the interest rate the development of wages and prices and employment) affecting the expenditure framework the Minister of Finance provides insight in the framework letter into the opportunities and problems regarding the next budget. This budget letter reviews in general whether cutbacks are required or whether there is room for additional expenditure, for a relief of the tax and premium burden or for an improvement of the public finances (reducing the financing deficit, realizing a surplus, repaying the debt).

Budget Letters And Budget Memorandums

Many documents are drawn up during the preparation of the budget and in the implementation phase, distinction may be made between budget letters and budget memorandums :

- (a) execution of its various programmes, projects, activities and schemes (Programmes activity and classification are suggested to remedy this),
- (b) It is difficult to see from the conventional budget and account heads for what broad purpose and objectives resources are being allocated. To remedy, this functional classification is suggested;
- (c) The classification does not permit a proper analysis of the impact of government transactions on the total national economy. (This is sought to be remedied by an economic classification), and

(d) It is not helpful as a basis for judging the progress made towards the achievement of goals and objectives as envisaged in the development plans.

In developing countries which are committed to bring about rapid socio-economic progress and development of their people, the bureaucracy has by trial and error become the major instrument of implementation of public policy. Developmental goals like improving the level of social services, health and education, building infrastructure like roads, communication facilities, electricity, and market centers or raising production in agriculture and industry incur much government expenditure. In the change-oriented milieu of development administration, a system so rigid checks and balances over financial administration may act as deterrent to increased government spending which is vitally necessary to lay the foundation of a social welfare state. Too much stress on economy and accountability may make the need of massive public investment and expenditure there is need for reforming the traditional concepts of accountability based budgeting. The budgetary system, especially in developing countries, needs result-oriented budgeting 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 an essential aspect of result-oriented budgeting.

Most of the shortcomings of the line-item budget were sought to be removed by the performance budget, a new concept in financial administration which first originated and developed in the USA. Since, 1950, the US government has adopted the performance budget. Several countries in Asia, Africa and Latin America have also incorporated the principle of performance budgeting, partially if not totally, in their budgetary systems.

In the 1960s an attempt was made to plan government expenditures on a long-term basis. Emphasis was placed on the predetermination of expenditures, over a five-year period, in accordance with the expected/desired rate of growth of the economy. Planned expenditures are broken down by major functional categories such as defense, education, health and welfare, housing, and so forth, which are to serve as guides in the preparation of annual budgets. The functional breakdown is also intended to assist legislative discussion.

More recently, the elaborate systems of planning and control developed in the 1960s have been abandoned. There is less, and less detailed, forward planning of public expenditure. Forecasts are presented in cash terms, and the levels of inflation or cost increases contained within them are only partly disclosed. The primary disadvantages of the old system were that it allowed expenditures to be driven excessively by the burden of past commitments and to be blown off course by rises in the cost of public sector inputs. The new system has almost the opposite weaknesses: it induces short-term planning, in which capital expenditure is squeezed in favour of current spending, and allows the volume of outputs and inputs to be governed by optimistic assumptions about price increases. According to some critics, this development, intended to assist in public expenditure control by providing simple-to-understand criteria, has, reduced public understanding of the public expenditure process and therefore the accountability of government for its actions.

Budget letters are internal documents from the Minister of Finance to his fellow ministers. They include proposals and data for the preparation and decision-making of draft budgets by the government (in the Council of Ministers). Such letters are not public.

Budget memorandums are external documents sent by the Minister of Finance on behalf of his colleagues to inform the legislative body. The documents are public and provide information on the financial-economic policy of the government. The best-known memorandum is the Budget Memorandum presented on Budget Day.

The ministers then discuss the framework letter in the Council of Ministers. This means that they jointly review the expenditure and receipts relating to the budget: where have additional claims been submitted, how are problems resolved and which opportunities for new policies are politically feasible⁹ Usually, general decisions are rendered after a couple of meetings on the objectives, expenditure, and receipts for the following year. The framework letter also immediately provides a budget total per ministry. The Minister of Finance sends these totals to the ministries in a letter, i.e. the Totals Letter. This letter includes a summary of the decision-making for the following budget year. In other words: it includes the figures which the budgets of the ministries must comply with.

Submitting The Preliminary Draft Budget

Then the ministers submit their preliminary draft budget to the Ministry of Finance. As the Minister of Finance is responsible for the general budget policy all separate budgets are submitted to and reviewed at the Ministry of Finance. It is reviewed per ministry whether the preliminary draft budgets comply with the negotiated agreements. Attention is thereby also drawn to the explanatory notes regarding the policy articles. It is reviewed whether it is clearly stated which objectives the ministry concerned wishes to attain, which performances must therefore be rendered and how much money must be spent on each objective. Intensive consultations are therefore held at senior officer level. Where points of conflicts remain, further consultations are held at an increasingly higher level up to the level of the ministers and secretaries. The consultations may result in changes. The Minister of Finance submits such changes to the Council of Ministers. The Ministry of Finance also prepares the Budget Memorandum stating the main lines of the financial-economic policy and the national and international economic developments.

Final Decisions On The Budget In The Council Of Ministers

In the decision-making round the up-to-date economic data from the organizations like central planning bodies are taken into consideration. The draft budgets may now be completed. The Budget is subsequently discussed and adopted in the Council of Ministers.

These follows,

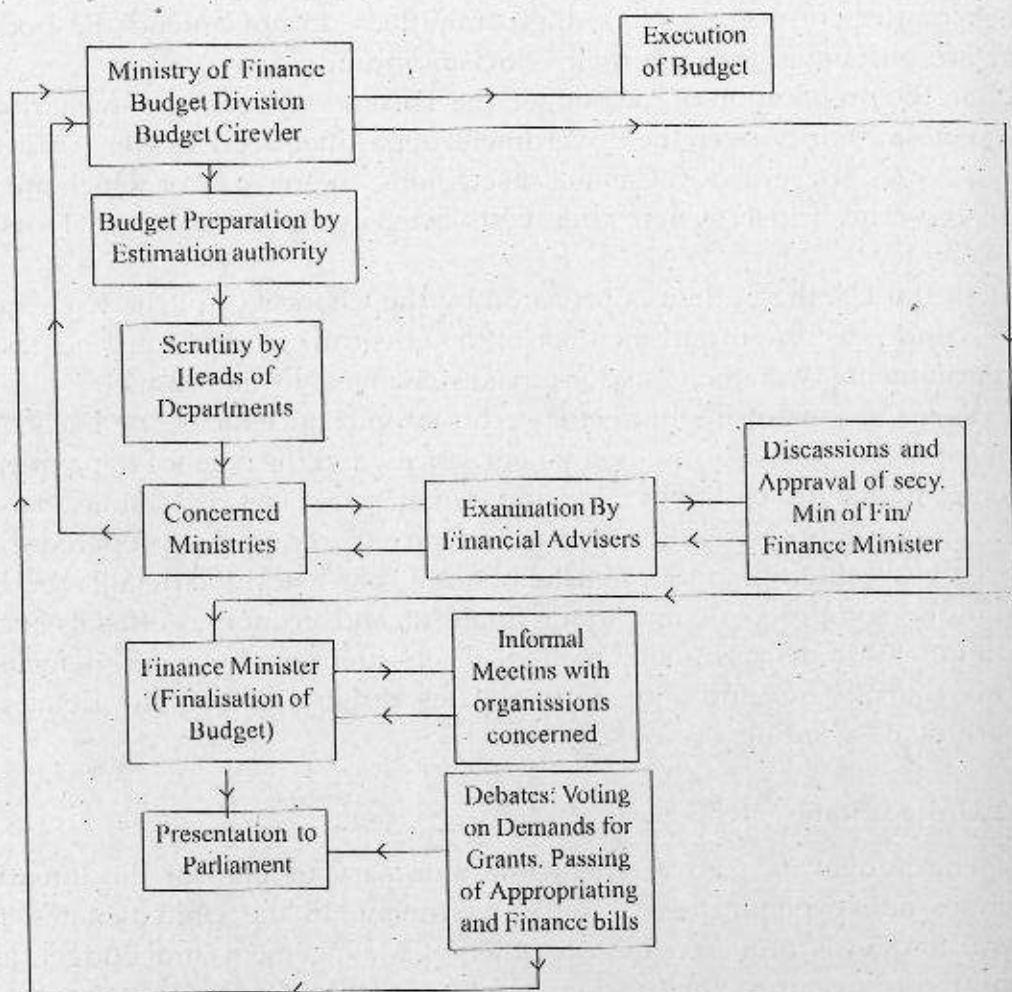
- The presentation of budget proposal on Budget Day
- The discussion and adoption of the budget
- Parliamentary approval following detailed discussion and amendments (if recommended by the majority)
- The implementation of audit and accounting for the budget
- Back to overview

1.2.1- Ministry of Finance

All ministers bear political responsibility for the preparation (and the implementation) of the budget of their ministry. For example, the Minister of Finance is responsible for the budget of the Ministry of Finance. As a specialist minister he is responsible for the expenditure of his ministry. In addition, he also has a special position in the budget process as he is responsible for the general budget policy. The Minister of Finance thereby has powers with

regard to the budgets of all other ministries. For example, all plans of ministers with financial consequences must be submitted to the Minister of Finance.

BUDGET PROCESS



1.3 □ Budget in Some Countries

1.3.1 United Kingdom

U.K. budget is submitted to Parliament by the chancellor of the Exchequer, who is responsible for its preparation. The emphasis of the

chancellor's budget speech is on taxation and the state of the economy, rather than on the detail of expenditures; public discussion is devoted mainly to the chancellor's tax proposals. The estimates of expenditures are sent to Parliament with less fanfare and are reviewed by the departmental select committees on estimates of the House of Commons. The reviews hardly touch matters of policy. While the committees do not amend the budget, they are influential through their criticism and advice.

In the preparation of the budget, the Treasury appears to have virtually complete authority over the government departments on matters of detail. Major issues are settled in Cabinet discussions, the records of which are not available. The British system thus vests extensive controls in the Treasury bureaucracy.

In the UK the budget is prepared by the Chancellor of the Exchequer, the second most important member of the government, and must be passed by Parliament. Parliament seldom makes changes to the budget.

A major part of the budget speech by the chancellor of the Exchequer is addressed to forecasts of employment, prices, and the balance of payments, together with a discussion of fiscal and monetary policies. Economic analysis is a continuing preoccupation of the Treasury. Forecasts are prepared three times a year, although only published once a year with little detail; a budget committee composed of important financial and economic officials meets continuously to discuss policy matters. Their attention, however, is focused on tax, borrowing, and monetary policies rather than on the details of government spending.

1.3.2 United States

The budget of a government is a summary or plan of the intended revenues and expenditures of that government. In the United States, the federal budget is prepared by the Office of Management and Budget, and submitted to Congress for consideration. Invariably, Congress makes many and substantial changes. Nearly all American states are required to have balanced budgets, but the federal government is allowed to run deficits. In the United States, the Congressional Budget Office is required by law to advise the legislature of the estimated costs (and the basis of the estimate) that proposed federal legislation would impose on state and local governments (and on the private sector). CBO's website at

<http://www.cbo.gov/>.

An important legislative oversight mechanism is the annual appropriations process. Congress determines the budget and appropriates money for the various administrative agencies. An administrative agency that angers Congress, or a key member, may find less money to work with next year, or even see certain programs eliminated.

The president also reviews agency budgets, through the Office of Management and Budget. A president's disapproval of agency initiatives can block appropriations in Congress.

Output budgeting is a wide ranging management technique introduced into the USA in the mid 1960s by Robert S. McNamara's collaborator Charles J. Hitch, not always with ready cooperation with the administrators and based on the industrial management techniques of program budgeting. Subsequently the technique has been introduced into other countries including the UK.

1.3.3 India

Finance Minister, assisted inter alia by the Budget Division of the Department of Economic Affairs of Ministry of Finance, has responsibility for producing the budget, in the form of the Annual Financial Statement and such supplementary budgets as may be needed during a year for the Government of India (other than for the railways). The Budget Division is responsible for issuing all instructions and guidelines for the preparation of budget estimates and for monitoring the timely receipt of the same from all the ministries concerned. The railway budget is prepared separately and presented to the Parliament a few days in advance of the general budget. The railway budget figures (net) are, however, also incorporated in general budget to give an overall picture of the financial position. The Railway Budget is presented to Parliament by the Minister of Railways.

In India, the Finance Minister prepares the Union Budget and presents it to the Lok Sabha, on the last day of February. It has to be approved by Parliament before April 1, the start of India's financial year. The day the Union Budget is presented and considered by many observers to be the most important of India's political calendar. It usually has an immediate effect on the nation's stock exchanges and also has possible short term political implications. This is in addition to the long term changes that some budgets may lead to, e.g. Manmohan Singh's budgets in the early 90's.

India is a 'Union of States' (Federal). The responsibilities and powers

(including financial) of the Union and the States, and the relationship between them, are set out in the Constitution of India. The legislative powers are detailed in three lists—Union, State and Concurrent. The Union list includes matters of national interest such as foreign affairs, railways, posts and telegraphs, currency and coinage, and inter-state trade and commerce while the State list contains matters of regional interest such as law and order, health, agriculture, irrigation, power, rural and community development. Certain matters of common interest, such as economic and social planning, have been placed under the concurrent legislative powers of the Union and the States. In the event of a clash between the laws of the Union and the States in the concurrent area, the laws of the former prevail.

The Constitution allots separate legislative heads of taxation to the Union and the States. Borrowing and foreign exchange entitlements are controlled by the Union. The residual powers of levying taxes not mentioned in the State list and the Concurrent list also rest with the Union. The division of fields of taxation between the Union and the States is based on economic and administrative rationale. The power to levy taxes with an inter-state base, and where uniformity in rates is desirable, is vested in the Union Government, but the power to levy taxes that are location-specific lies with the States. However, certain taxes are levied by the Union but are collected and retained by the States, while certain other taxes and duties are levied and collected by the Union but their net proceeds are assigned to or shared with the States.

The Constitution provides for payment by the Union of grants-in-aid of revenues to the States. The Government of India is also empowered to make loans to the States or give guarantees in respect of loans raised by them. There is also provision for grants by the Union or a State for any public purpose.

The audit of the accounts of the Union and of the States is a Union responsibility. Accordingly the accounts of the Union and of the States are to be kept in such form as the President of India prescribes on the advice of the Comptroller and Auditor General of India (CAG). There is thus a unified system of auditing and accounting, facilitated by Parliament enacting a law governing the duties, powers and conditions of service of the CAG known as the Comptroller and Auditor General's (Duties, Powers and Conditions of Service) Act 1971.

The financial management systems and accountability mechanisms, both

at Union and State levels, are almost the same except in certain details. Unless specifically mentioned, the systems detailed below in respect of the Union apply also to the States.

The executive authority of the Union is vested in the President of India who exercises this authority either directly or through officers in accordance with constitutional provisions. However the President has been placed under a firm constitutional obligation to act in accordance with the advice tendered by the Council of Ministers headed by the Prime Minister. In the States it is the Governor who discharges the executive functions of the State with the aid and advice of the Council of Ministers headed by the Chief Minister.

The financial year in India is from 1 April to the 31 March of the following year. The annual financial statement of receipts and expenditure of the Government is required to be placed before the Parliament/State Legislature which, in each case, confers specific authority for raising revenue through taxation and incurring expenditure. In this regard, no tax can be levied or collected except by authority of law while, similarly, no moneys can be appropriated from the Consolidated Fund except in accordance with law and for the purposes and in the manner provided in the Constitution.

The Constitution of India provides for the creation of three separate funds both at the Union and State levels.

- (i) Consolidated Fund (Art. 266 and 283) : All revenues received by a Government, all loans raised by that Government by the issue of treasury bills, loans or ways and means advances and all moneys received by that Government in repayment of loans, form the one Consolidated Fund.
- (ii) Contingency Fund (Art. 267 and 283) : The Contingency Fund is in the nature of an imprest, into which are paid from time to time such sums of money as may be determined by law. The Fund is placed at the disposal of the President of India or the Governor of the State, as the case may be, to enable advances to be made for the purpose of meeting unforeseen expenditure pending authorisation of such expenditure by Parliament or State Legislature.
- (iii) Public Account (Art. 266 and 283) : All other moneys not forming part of the Consolidated Fund, received by or on behalf of the Government, are credited to the Public Account.

The demarcation of moneys received by the Union or a State Government

into three separate funds is based on a rational basis. All the moneys whether received by way of tax or non-tax revenues, or from any other source where the ownership of the moneys vests with the Government, form part of the Consolidated Fund. Moneys received by or on behalf of the Government where the Government acts as a trustee form part of the Public Account. The nature of the Contingency Fund is self-evident. No moneys can be withdrawn from the Consolidated Fund for incurring any expenditure without prior approval of the Parliament or the State Legislature through a process of legal appropriation. Therefore unforeseen expenditures, or expenditure in excess of approved appropriations, are met from the Contingency Fund. The Parliament of India and the various State Legislatures have passed laws establishing such Contingency Funds.

1.3.3.1 The Role Of Parliament In Financial Accountability And Management In India

Although the Indian Constitution does not mention the term 'Budget', it provides that the President shall in respect of every financial year cause to be laid before both the Houses (The Houses are the House of People (Lok Sabha) and the Council of States (Rajya Sabha) of Parliament a statement of the estimate receipts and expenditure of the Government of India for that year. This statement, known as the Annual Financial Statement, is the main fiscal or budgetary document of the Government.

The estimates of expenditure embodied in the Annual Financial Statement are required to show separately:

- (i) Sums required to meet expenditure described under the Constitution as 'Charged' upon the Consolidated Fund of India.
- (ii) Sums required to meet other expenditure proposed to be made from this Fund, i.e., expenditure which is subject to Vote of the Parliament.

The estimates are also required to distinguish expenditure on revenue account from that on capital account. A further classification of expenditure is made on the basis of its being a part of 'Plan Outlay' or non-plan, i.e. expenditure which is part of normal governmental activities or maintenance expenditure.

The expenditure of the following nature is charged on the Consolidated Fund and is not subject to Vote of Parliament:

- (i) emoluments and other allowances of the President of India; Presiding Officers of the two Houses of Parliament;

- (ii) salaries and allowances, etc. of the Judges of the Supreme Court; Comptroller and Auditor General of India;
- (iii) debt redemption charges, including interest;
- (iv) any sums required to satisfy any judgment of the Court or a legal tribunal, as also
- (v) any other expenditure which might be declared by the Parliament by law to be a charged expenditure.

The expenditure estimates which form part of the Annual Financial Statement are divided into different Demands for Grants. The Demands for Grants, as mentioned earlier, show separately the revenue and capital, and the charged and voted expenditure. Similarly, estimates of receipts are classified in the tax and non-tax categories and also those which are on revenue account and others which are on capital account (in common with public loans). The Demands for Grants (voted portion) are submitted before the Lok Sabha and put to vote. This House has the power to assent or refuse to assent or reduce the amount of the Demand. The Demands relating to 'Charged' expenditure are not subject to any vote, but Parliament is free to discuss any of these Demands and express its opinion for the consideration of the Government. The Demands for Grants before they are submitted to the Parliament require a specific recommendation of the President (or Governor in the case of a State).

After the Demands for Grants have been approved by the Lok Sabha (or the State Legislative Assembly), an Appropriation Bill to authorise the Government to withdraw moneys from the Consolidated Fund is required to be introduced and passed by the Parliament (or the State Legislature). It is through the medium of this Appropriation Act that the constitutional requirement of parliamentary financial control is met.

A similar procedure is mandatory for providing supplementary or additional funds required in a particular financial year, and for regularising any excess expenditure over the approved appropriations. For this purpose, Supplementary Demands for Grants or Demands for Excess Grants have to be presented and relevant Appropriation Acts passed.

1.3.3.2 Votes on Account

Since India has an annual budget cycle in respect of each Appropriation, the entire budgetary process is to be completed, according to constitutional

and legal requirements, for the next financial year, before the end of the current financial year i.e. before 31 March. In a country of the size of India with widespread activities of the Government, the budgetary process has to start at least six to seven months before the commencement of the next financial year. The process of estimation starting from the lowest activity centre up to the apex level of the Ministry of Finance and the Cabinet has to be completed at least a month before the commencement of the next financial year. Therefore, normally by end of February, the budget estimates and other related documents are presented to the Parliament. It is, however, not possible always to complete the entire legal process of consideration, discussion and approval of the estimates and related appropriation and other finance bills before 31 March. In order therefore to enable the Executive to carry on the activities of the Government uninterruptedly, the mechanism of allowing supplies in the interim for a part of the financial year has been provided through the medium of Vote on Account.

1.3.3.3-The Role of The Executive In Financial Accountability And Management

The Council of Ministers headed by the Prime Minister is collectively responsible to the Parliament. Each Minister holding a portfolio for formulating departmental policies is individually responsible, as well as collective responsibility to oversee the implementation and ensure the efficient working of the administrative machinery under his charge. Individual Ministers are responsible to the legislature for actions of their respective civil servants, who, in turn, are ministerially accountable. Accountability is made more specific and is ensured by a complex set of organisational and procedural devices.

1.3.3.4-Ministry of Finance

The control over finances of Government has traditionally been confined to the Ministry of Finance. With the phenomenal growth and the complexity of Government activities, several powers have been delegated to Administrative Ministry, but the Ministry of Finance continues to have the overall responsibility of co-ordination and control. For speedy and effective discharge of their functions in financial matters, which include planning, programming, budgeting, internal control, monitoring and evaluation, an

Integrated Financial Adviser is attached to each Administrative Ministry. The Integrated Financial Adviser acts both as internal and external financial adviser. He functions as internal financial adviser in the exercise of powers delegated to the Ministries under the Delegation of Financial Power Rules, and acts as an external financial adviser on behalf of the Ministry of Finance in respect of matters outside the delegated financial powers of the Administrative Ministry.

The Ministry of Finance has issued detailed regulations on financial management and control to be followed uniformly in the Govt. of India. In addition, the Ministry is responsible for framing rules relating to the maintenance of accounts of the Union and of the States, on the advice of the CAG. The CAG provides the Union and State Govts. with any information requested from time to time regarding accounts for the compilation and maintenance of which he is responsible. The CAG also renders all reasonable assistance sought by the respective Govts in the preparation of their annual financial statements (budget estimates).

1.3.3.5-Administrative Ministries

The basic responsibility for the administration of each department's activities is entrusted to the Head of the department concerned, who is guided and controlled by the Administrative Ministry. In financial matters each head of the department is thus responsible for the collection of revenue and control of expenditure pertaining to his department, the receipt and disbursement of which are usually effected in various places and through various persons. The Ministries also exercise financial control over public enterprises set up under each of them. The Permanent Secretary of each Ministry who is the Chief Accounting Authority for that Ministry, discharges this function through and with the assistance of the Controller of Accounts and the Financial Adviser.

Once the Appropriation Bill (Vote on Account) or the Appropriation Bill relating to the whole year, as case may be, is passed by Parliament, the Ministry of Finance advises the other Administrative Ministry of the Grants made by the Lok Sabha and the Appropriations sanctioned by Parliament. Each Ministry of the Union Government may distribute the funds, where necessary, among the controlling and disbursing officers subordinate to it. Unspent balances are unavailable for utilisation in the following year. Officers incurring or authorising expenditure from public moneys must comply with the prescribed standards of financial propriety.

The various Ministries are responsible for the control of expenditure against the financial grants and appropriations placed at their disposal, control being exercised through the respective Controlling Officers. For this purpose there are well laid down procedures and management information systems. All anticipated savings in the grants are surrendered to the Ministry of Finance, before the close of the financial year, for possible reappropriation as permissible under the rules of appropriation.

1.3.3.6 Transfer of Appropriation

No expenditure can be incurred which may have the effect of exceeding a grant authorised by law for a financial year, except after obtaining a supplementary grant or an advance from the Contingency Fund. Since voted and charged portions-in common with the revenue and capital sections of individual grants-are distinct and reappropriation inter se is not permissible, an excess in any one portion or section is treated as an excess in that particular grant. However, reappropriation of funds from one primary unit of appropriation to another such unit within a grant may be sanctioned by a competent authority at any time before the close of the financial year, subject to certain restrictions.

1.3.3.7 Other Central Agencies

Besides the Ministry of Finance, the Finance Commission and the Planning Commission play an important role in public finances of the country. The Finance Commission makes recommendations relating to the distribution of net proceeds of certain taxes between the Union and the States and the 'payment of grants-in-aid of the revenues of the States out of the Consolidated Fund of India. The Planning Commission, besides formulating and monitoring development plans, advises the Union Government regarding the desirable transfer to the States of resources essential for developmental outlays. These transfers are over and above those recommended by the Finance Commission. Its recommendations cover among other things, feasible changes in tax rates and efforts, quantum and allocation of borrowings between the Union and the States.

1.3.3.8 Role Of The Reserve Bank Of India

The Reserve Bank of India, which has been set up as a Central Bank by

an Act of Parliament is the repository of all cash balances of the Government of India and of all the States except in the case of two States. It plays a vital role in assisting the Government in the economic management of the country, particularly the monetary system. The Govt. of India borrows from the Reserve Bank against issue of treasury bills for replenishing its cash balance from time to time. The State governments also obtain ways and means advances as bridging loans from the Bank, which are repayable within a specified period.

The Reserve Bank has been entrusted with the responsibility of management of public debt raised by the Government of India and of the States including maintenance of detailed accounts of all the loans floated. The Bank has also been entrusted with the complete control of foreign exchange of the country.

Policy changes being introduced and their expected fiscal effects as part of the budget documentation. This allows clear identification of factors causing budget outcomes to diverge from planned spending and thus improves accountability for fiscal policy implementation. It also provides a basis for a disciplined medium-term budget framework. Best practice is that the estimated fiscal effects of all proposed central government legislation, including the cost implications for subnational levels of government, should be made publicly available. In Hong Kong, the annual budget documentation provides a clear statement of fiscal policy objectives and medium term sustainability,

In Hong Kong SAR, a medium range forecast is prepared and published as an annex to the budget speech :

In South Africa, a Medium Term Budget Policy Statement is presented to parliament three months before budget day. It contains the macroeconomic assumptions, proposed inter-provincial allocations, the expected functional classification of expenditure, and the expected split between capital and current spending (Folscher (1999).

United States budget for 1999 contains detailed information on the long-term implications of current fiscal policies. In an "Analytical Perspectives" publication provided as part of the budget documentation projections are given for the budget to the year 2070. The key assumptions are described, and illustrations provided of the sensitivity of the projections to alternative assumptions and scenarios. Long-term (75 year) projections of the income and outgoings of the Social Security and Hospital Insurance Trust Funds are

also provided, including the estimated 75-year actuarial balance of the Trust Funds as a summary measure of their financial status.

The medium range forecast involves projections for the budget year plus three years. Hungary has also started to present its budget in the context of a three-year outlook for the budget and the economy.

The United Kingdom budget for 2000 contains information on generational accounts for the United Kingdom (including comparative information for other countries), in the context of a detailed discussion of long term fiscal sustainability.

In Germany, the Law on Budgetary Principles, for instance, explicitly requires multiyear financial planning by all levels of government. To coordinate this task, a Financial Planning Council comprising the minister of Finance (chairman), the minister of economics, the state ministers responsible for financial affairs, and four representatives of municipalities was created in 1968. A good example of this is the reporting of budget measures in the United Kingdom, where a summary table of new budget measures and their estimated fiscal effects is provided in the budget document, and an annex expands upon each new measure in more detail. In France, existing policies expenditure ("appropriations for current services") is clearly distinguished from "items of expenditure reflecting new policies." This distinction is required by the organic budget law and, under that law, current services appropriations are subject to only one vote in parliament while new policy items are subject to detailed voting processes.

In recent years Greece has strengthened its reporting of fiscal risks. Risks from variations in macroeconomic assumptions, contingent liabilities, and other uncertainties are now examined in the budget document. IMF Staff Country Report No. 99/138 (pp. 49-53) discusses fiscal transparency in Greece. An example of comprehensive reporting.

In India there has been a growing awareness among the public sector policy makers and executives of public enterprises of the need to take various remedial measures to correct adverse trends in public enterprises. There is a quest for increasing efficiency, optimising performance and ensuring better financial results. With the exception of a few small public enterprises which have been wound up, there has been no concrete case of 'privatisation' in India, as it is commonly understood. However the Government of India has recently sold limited shares of some public enterprises to mutual funds and

has announced its intention of selling up to 49 percent of equity to certain financial institutions and to the public.

1.3.3.9 A Summary On Budget Steps

The General Financial Rules prescribe the broad guidelines, procedures and forms for the preparation of budget estimates of receipts and expenditure by the ministries. In addition, the Budget Division issues a circular, normally during September each year, known as the 'Budget Circular' for the next financial year (which is 1 April to 31 March as indicated earlier) for preparation of the Revised Estimates of the current financial year and the budget estimates of the ensuing financial year. This circular gives detailed instructions about the preparation of estimates of receipts and expenditure, the required format and the various statements that are to be appended to the estimates. It also specifies the processes to be followed and their scheduled dates.

The estimating authorities prepare the detailed estimates of receipts separately for each Major Head of account. For each Major Head, break-up of minor/detailed heads (to be in conformity with the accounting classification) is given, taking into account the actuals for the past three years. Relevant notes are given to highlight any individual items of significance or explanation for any major variation with reference to past actuals. The detailed estimates of expenditure are prepared by the estimating authorities by each unit of appropriation (sub/detailed head) under the prescribed Major and Minor Heads of Account separately for Plan and Non-plan expenditure. The estimates of Plan expenditure are made on the basis of the approved plan allocations intimated by the Planning Commission.

The estimating authorities forward the budget proposals to their departmental heads for consideration and onward transmission to the ministries administratively concerned. These ministries scrutinise the estimates, make modifications where necessary, and transmit these revised estimates to the Financial Adviser for further examination and processing. The Financial Adviser ensures the correctness of accounts classification, makes modifications as may be called for in his judgement in the context of economy and other considerations, consolidates the estimates for each programme/organisation to present a complete picture of their financial costs, and obtains approval of the Secretary (Expenditure) in the Ministry of Finance, wherever necessary. Departmental budgets are then forwarded to the Budget Division. While the prescribed date for receipt of the estimates of receipts by the

Budget Division is normally not later than the end of December, the date for estimates of expenditure is 31 October. The estimates of departmental receipts and expenditure received in the Budget Division are duly scrutinised and then accepted for incorporation in the Budget.

Before finalising the budget proposals the Finance Minister holds informal meetings with organisations representing industry, agriculture and other key sectors. He also meets leading economists to ascertain their views on matters having a bearing on the fiscal policies of the Government. The budget proposals are placed before the Parliament by the end of February. The railway budget, as already mentioned, is presented separately a few days in advance of the general budget.

Clear description, including careful costing, of continuing government programs and new policies are vital elements of budget discipline. Countries should include a statement which describes tax and expenditure information on fiscal risks in the annual budget is provided by New Zealand.

The emergence of new debt creating obligations that may be excluded from routine fiscal projections—such as contingent liabilities that may have to be honored—should also be taken into account. Budget estimates and the economic forecasts underlying the budget are subject to a variety of risks. The effects of variations in the assumptions and parameters underlying the macroeconomic forecasts and individual program estimates, as well as uncertainty over the costs of specific expenditure commitments are matters of concern. Best practice is that a statement of fiscal risks should be included in the budget documentation as a basis for assessing the budget's reliability as a guide to likely fiscal outcomes and new policies being introduced in the annual budget should be clearly described.

Statement of Fiscal Risks should be provided with the annual budget giving an overview of all material fiscal risks, quantified to the extent possible. Where allowance for a risk has been made in a budget contingency reserve this should be noted. The statement should contain information on risks broken down into the following categories:

- (1) variations in key forecasting assumptions—the fiscal effects of variations in key assumptions underpinning the macroeconomic forecasts (e.g., the effect on the fiscal deficit of a 1 percent increase or decrease in GDP growth, inflation, interest rates, or the exchange rate from the central rate assumed in the budget forecast); and the fiscal effects

of variations in key assumptions underpinning the budget forecasts of revenue and expenditure (e.g., a variation in the effective tax rates, public sector wage increases, or the average number of claimants for social assistance).

- (2) contingent liabilities—these may include guarantees, indemnities, and warranties; uncalled capital (e.g., in international financial institutions); and litigation against the government.
- (3) uncertainty about the size of specific expenditure commitments—where provision has been made in the budget for expenditure on an item or activity but there is a greater-than-usual degree of uncertainty about the likely cost, the risk should be disclosed. For example, the government may have given a blanket undertaking to depositors of a specified distressed financial institution that their deposits would be honored. However, at the time of finalizing the budget, the cost of this commitment may still be highly uncertain.
- (4) other items that have not been included in the budget because of the extent of uncertainty about their timing, magnitude, or eventuality—for example, the government may have announced a general intention to introduce a tax or expenditure policy change, the details of which have not been finalized sufficiently for inclusion in the budget.

There may be some instances where there are legitimate public policy reasons not to quantify a fiscal risk, this might be the case, for example, where to do so would result in disadvantage to the government in negotiations with third parties. The existence and nature of the risk should however still be disclosed.

1.4 □ Deficit Financing

This Deficit financing occurs mainly because of government's important requirement. When expenditure is more than receipt, that is expenditure is 100 and receipt is 80, it is called deficit; in this case deficit is Rs. 20. This deficit of 20 is to be compensated by printing notes. Money supply will be increased in market, resulting in inflation and involuntary savings. Deficit financing leads to a somewhat forced saving. Poor people have to face more problems due to increase in price.

Reasons for deficit financing are as follow :

In a developing country, the government has to take social sector into consideration and therefore a number of subsidies needs to be given.

The government has to create employment avenues.

The public expenditure mainly non-planned expensive rises considerably causing deficit.

Effects of Deficit Financing:-

1. Forced Savings
2. Growing interest burden on Government.
3. Inflationary rise in prices (deficits breed further deficit it is a cumulative process).
4. Change in the pattern of investment. Now instead of planned expenditure there will be more non planned expenditure.
5. Interest rate increases because of the more money supply, thereby further adding to the liabilities of govt. because internal borrowing will be costlier, which further adds to fiscal deficit.

1.4.1 Fiscal Deficit

This deficit measures the gap between what the government intends to spend, including loan repayment, and what it will earn from the tax revenue- for example dividends from the Public Sector Enterprise (PSEs), foreign grants, interest on its own loans. The impact of the fiscal deficit is very dangerous. The bigger this gap, the more the government will have to borrow or print money or both to make both ends meet.

FISCAL DEFICIT:- (FD)= Budgetary Deficit-Government market borrowing + liabilities or

$$FD = \text{Revenue Receipt} + \text{Capital Receipt} - \text{Total Expenditure}$$

1.4.2 Revenue Deficit

This measures the gap between what the Government's consumption expenditure-everything from interest payment and revenue. It's like a household borrowing just to eat. Smallest of all deficits is Revenue Deficit. But it is most potent one.

RD= Revenue Expenditure – Revenue Receipt.

RD= (Tax + Non tax receipt) – (Planned + Non Planned Expenditure)

1.4.3. Budgetary Deficit

It is the most dangerous deficit. Though this deficit is officially just the net R.B.I, credit to the Central Government, in actual practice it is like printing notes to finance Government overspending. BUDGETARY DEFICIT (BD) = Total Expenditure - Total Receipts.

Now the Central Government of India tries to meet its all deficit by the process of WMA (ways and means advance) and this concept is a part of future Zero Based Budgeting).

Module-II ● Unit 2 □ Programme and Performance Budgeting

Structure

- 2.1 Programme and Performance Budgeting**
 - 2.1.1 Meaning And Features, Measurement**
 - 2.1.2 Principles**
 - 2.1.3 Processes of Performance Budgeting**
 - 2.2 Planning Programming and Budgeting System (PPBS)**
 - 2.2.1 Planning**
 - 2.2.2 Programming**
 - 2.2.3 Budgeting**
 - 2.3 Zero-Base Budgeting**
 - 2.4 Bibliography**
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2.1 □ Programme and Performance Budgeting

2.1.1-Meaning And Features, Measurement

Performance budgeting is a financial document that seeks the implementation and control of government programmes through budget allocation. This is done by presenting government operations in terms of programmes, activities and functions. Through such a functional classification of governmental financial operations, public policies are sought to be identified and 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 or assessed. In performance budgeting, the focus is on the end rather than on the means. The main purpose is to clearly define the objects of governmental spending, the work to be performed and an estimated cost of performance. The concept of a programme budget, which is also called a performance budget, sets in advance the targets and the authorizations against which the performance of the governmental departments can be assessed periodically. It serves as a basis of efficiency and work measurement qualitatively and quantitatively. The performance of

the past years serves as an evaluation sheet for next year's budgetary targets and estimates. Performance budgeting shifts the emphasis from the means of achievement to the achievement itself, from what the governmental buys and acquires, to the service rendered. The differences between a line-item budget and a programme budget has been aptly summarized in the following lines:

A line-item budget shows how many clerks will be hires, how much travel money will be spent, how much will go for printing or mimeographing, and what will be expended, for papers, typewriters, and stationary. The plans are based on these line-items; the controls are geared to these lines; the information has to do with the things used. In sharp contrast, the programme budgets starts with the work to be done, the costs of the various work units, the purpose of travel, the ends to be served by printing or office supplies. The programme plans are in terms of the jobs to be accomplished; the controls are related to responsible management, the information tells what works is being or will be done in relation to what was authorized in the past.

Performance budgeting comprises five essential elements :

- (a) programming, or the subdivision of the government budget for information purposes into programmes and activities representing identifiable unit with similar aims and/ or operations;
- (b) identifying the operational aims of each programmes and activity for the budget year;
- (c) budgeting and accounting for each programme so that the separate costs and revenues each programme and activity are shown,
- (d) measuring the outputs and performance of activities so that these can be related to their cost and to operational aims; and
- (e) using the resultant data to establish standards and norms so that costs and performance can be evaluated and government resources used more efficiently.

Performance budgeting, in its simplest terms marks the move away from merely managing numbers in a budget toward some understanding of outcomes. These outcomes can be widgets produced, hours spent in training for war, or clients seen by an agency. It marks the first steps toward the use of policy-based outcomes.

The traditional budget is generally an incremental line-item budget based on historical or empirical methods of estimating revenues and

expenditures. Soon after national independence, the Government launched comprehensive socio-economic development through five year plans, divided into annual plans. Apart from a detailed planning process, these involved three major concerns:

- (i) raising and allocating additional resources-both internal and external;
- (ii) enlarging the responsibility functions of budgets, and
- (iii) strengthening the systems of expenditure control.

Following national independence, there was a growing awareness by legislators, taxpayers and budget authorities of the need for a structural change in the budget so that additional budgetary input could be compared with additional output. In 1965 the United Nations published a Manual for Programme and Performance Budgeting and suggested that the developing countries could adopt this technique with view to obtaining a better return on resources. The Indian Government appointed a high-level Administrative Reforms Commission which recommended the introduction of a performance budget as an instrument for budgeting in terms of physical inputs and outputs, in addition to budgeting purely on financial terms.

As a result of this recommendation performance budgets were developed taking into account international practices in conjunction with the national planning structure. The Planning Commission, which acts as the apex body of planning in India for all sectors, substantially performs the planning functions of the budget, in contrast to other countries where these are handled by the Ministry of Finance, the Treasury or other budgetary authorities. Performance budgets in India are prepared in addition to the budgetary documents required under constitutional or other legal provisions. Emphasis is placed on comparing the effects of financial inputs with physical outputs. These budgets provide various performance indicators in both financial and physical terms.

2.1.2 Principles

There are three interrelated considerations or basic steps in the development of performance budgeting in an organization. They are:

- a) Evolving a meaningful classification structure in terms of programmes, projects and activities under each function entrusted to an organization in order to show precisely its objectives, the work done and the organizational responsibilities
- b) Bringing the system of accounts, reporting and the prevailing financial

management practices in general into accord with the now classification and requirement of performance budgeting, and

- c) Establishing suitable work units work for physical measurement of work done, or services rendered under each programme and activities and developing suitable norms, standards and other performance indicator for appraisal of performance.

In fact, performance budgeting attempts to integrate the planning, budgeting, costing, reporting and control systems of the organization.

In its ultimate application, this approach involves a sound budgetary operation, financial discipline, skilled and responsible manpower both for budget formulation and for execution, a frequent and efficient system of recording and reporting financial and physical data, and close coordination between various governmental agencies and the centre budget agency.³

Performance budgeting is very useful for developing countries. It facilitates better programming, decision-making, review and control for a more intelligible presentation of government activities to the public and the legislature. Broadly speaking, the main purposes sought to be served by performance budgeting are:

- a) To correlate the physical and financial aspect of every programme/activity;
- b) To improve budget formulation, review and decision making at all level of management in the government machinery;
- c) To facilitate better appreciation and review by the legislature.
- d) To make possible more effective performance audit;
- e) To measure progress towards long-term objectives as envisaged in the plan;
- f) To bring annual budgets and development plans closely together through a common language.

2.1.3. Processes of Performance Budgeting :

A performance budget is prepared in functional categories, such as agriculture, education, industry and health. Each functional category is divided into 'programmes', for instance, health may be divided into primary health, child health, and public health. Each programme is subdivided into activities which in turn, are further divided into 'projects'. Activity constitutes the collection of similar types of work in a programme, the purpose of which is to contribute to the achievement of the latter, for example, training of

primary rural health workers in an activity in the public health programme. 'Project'⁵ entails any activity which requires capital investment, such as building hospitals and health clinics. There are four main steps or phases of performance budgeting. They are:

- (i) compiling a functional classification of all governmental activities in the manner discussed above;
- (ii) evolving a system of fiscal management and cost reporting which may be in accordance with the objectives of a programme budget;
- iii) developing accurate statistical weights and measures of assessing government performance in terms of adequacy and unit costs; and
- (iv) establishing in the budgetary processes, an objective system of performance evaluation to provide periodic feedback to executors of public policies.

The entire budgetary process of a performance budget entails certain basic steps:

The first step is to indicate the organizational structure of the agency and the objectives of that table. Tabular presentation of the budgetary needs of the organizations, contains three basic elements:

- (i) a programme and activity classification;
- (ii) object-wise classification showing the same expenditure divided into broad object-wise expenditure groupings, such as establishment charges, travel, grants-in-aid, etc; and
- (iii) sources of financing indicating the demand numbers and major heads under which these outlays are included in the current appropriation structure. The third step consists in providing an explanation of the financial requirements. This needs to be done with reference to each of the programmes included in the table. The purpose of this explanation is to provide some indicators that are capable of reflecting the performance aspects of the organization.

Performance budgeting serves many useful purposes and fulfils many shortcomings of the line-item budget.⁶ It is becoming increasingly popular as a tool of fiscal management and policy in modern financial administration.

In the first place it makes it possible to establish identifiable linkages between policy and performance, inputs and outputs, the physical and financial aspects of governmental programmes and activities.

Secondly, it would improve upon the budgetary processes and related

fiscal policy making coupled with the analysis of actual governmental performance.

Thirdly, it would help to evolve a better system of financial accountability and legislative control. Fourthly, it would facilitate the processes of audit of government operations.

Fifthly, it would make effective result-oriented assessment of the long-term development policies of the government.

Sixthly, it would be the innovator of far-reaching reforms in financial administration. Seventhly, it would help eliminate waste and inefficiency in the financial transactions of government, make budgets y direction oriented and more development motivated.

Last but not the least, it fixes responsibility very precisely besides giving a clear picture of revenue and expenditure alternatives.

The adoption of performance budgeting imposes many initial difficulties especially in countries where the traditional form of budgeting has been continuing for a long time. The major reasons for this discussed as follows:

- (a) The government performance is not always easily quantifiable and often may not have clearly visible results. In the absence of quantitative performance units an attempt to correlate plan programmes to budget heads often become a futile exercise, for example, law and order activity is a government activity whose 'result' or 'performance' cannot be very objectively measured.
- (b) The difficulty relates to the lack of cost-accounts. Many assets of the government agencies cannot be accounted for in terms of unit costs.
- (c) A problem in adopting the performance budgetary procedure is the arduous task of linking accounting heads with development heads. The difficulty arises due to the fact that the development heads such as agricultural production, education, and health are spread at different major heads of accounts, with the result that it is very difficult to decipher the total expenditure on all the schemes under a development head. Therefore, it is often impossible to know what had been originally planned and their costs.

In India, proposal in favour of performance budgeting started originating in the mid-fifties. The Estimates Committee discussed budgetary reforms in its twentieth report and recommended the adaptation of performance budgeting in India. It reiterated this recommendation again in its report in 1960.

Following the recommendation of the Administrative Reforms Commission in 1968, strongly urging the central and state government to adopt this new form of budgeting, performance budgets of four central ministries were prepared that year. In 1977-78 about thirty-two developmental departments in the central government switched over to performance budgeting. Many state governments have also now introduced performance budgeting in selected departments.

However, the system of performance budgeting in India suffers from the same limitation discussed earlier (in the limitation of performance budgeting). Problems have arisen in the setting up of work units and in estimating costs. Regional diversities have resulted in different local precedents in costing procedures. In the absence of universal norms and standards of performance evaluation much of the benefits of this type of budgeting in terms of efficiency and performance are lost. In India, the achievement figures are often not quoted in concrete physical terms and techniques of cost measurement has not been followed right down to each cost centre. Targets and estimates are yet to be explained in terms of relevance and objective as clearly as they should be.

To overcome these shortcomings a reorganization of the heads of accounts to bring them inline with the heads of development is first required.

A reform in the accounting system is also called for. A measure of rationalization of the administrative organization of government ministries and department will also facilitate the processes of performance budgeting. Lastly, a complete integration of planning and budgeting is imperative for a greater degree of success in the 'performance' of programme budgeting in India. Performance budgeting as a tool is manageable or unwieldy depends largely on the skill of the tool-maker. How effectively it is applied depends on the skill, imagination, energy and strength of purpose of the user. All it can provide is a meaningful basis for administrative planning, executive coordination, legislative decisions and administrative accountability at all levels of government. It is by no means a substitute for responsible public administration.

2.2 □ Planning, Programming and Budgeting System (PPBS)

Schick (1966) has described the application of PPBS as being an effort to change the fundamental, repetitive cycle of budgeting to that point (at the

federal level) toward one that was future-oriented. Jones has described the application of PPBS in the Department of Defense and found this to be essentially true—particularly for well-settled issues such as the impact of U. S. commitments abroad or PBS requires Planners focus on operational requirements, programmers link the plans to a six year financial plan (known as a Future Years Defense Plan (FYDP)), and budgeteers prepare a two year Congressional budget. While each step contains more detailed financial data, the two-year Congressional budget stems from the six year Future Years Defense Plan, which is based on the even longer term Defense Plan.

As the name suggests, the Planning, Programming and Budgeting System (PPBS) has three components: planning, programming and budgeting. The ultimate objective of PPBS is to provide the best mix of forces, equipment and support attainable within fiscal constraints. PPBS enables senior leadership to assess alternative ways to achieve the objectives established by the President and the Secretary of Defense. The decisions from the PPBS involve balancing near term readiness, sustainability and force structure requirements with long term modernization needs to ensure a warfighting capability today and in the future. The PPBS process is run on a very structured schedule because of planning constraints for a particular Fiscal Year.

The first attempts to bring rational choice to the management of a defense budget coincided with the U.S. involvement in Vietnam. Terms such as systems analysis, as well as planning, programming, and budgeting systems (PPBS) and functional costing, became common in defense management. Much of the intellectual capital invested in these techniques came from economists, whose discipline in costing.

2.2.1 Planning

Program planning establishes a direct linkage from strategy to programmatic decisions through a single organization in order to develop comprehensive roadmap's comprising end-to-end analyses of warfare capabilities. Program planning seeks to answer the following questions:

How is the defense capability requirement entered into the next decision-making (PPBS) cycle?

How much of this capability can be afforded?

What programmatic adjustments must be made to gain/prepare for this desired capability?

The capability of manpower and personnel is measured as a function of quantity (ability to provide specific numbers of military and civilian personnel to meet requirements) and quality (ability to provide specific skills, grades & experience levels to meet requirements). End-to-End Capability is expressed as the ability to access, retain, and distribute specific quantities of trained personnel to fill defense requirements.

2.2.2 Programming

The objectives are to:

- Match available resources against validated requirements
- Convert planned requirements into resources needed to provide them
- Develop a balanced defense program for submission to government
- Defend the proposal through program & budget review

All the web addresses given in bibliography.

2.2.3-Budgeting*

The budgeting program is analyzed for near year execution. The output of the exercise is constituted by the budget exhibits, by budget line item. Adjustments to it may be made by holding hearings by providing justifications of programmatic changes. The budget process accommodates changes.

treaties on defense spending. He also found that PPBS did not respond well to short-term issues any day- to-day conflicts. Schick (1975) by the time that PPBS had been abandoned by the federal government defended its use by raising its short comings, and are useful as advice for those considering policy-oriented budget decision systems.

Both Schick and Lee have identified the value of policy-oriented budgeting systems as their ability to move the budgeting process itself away from the traditional serial, repetitive nature toward the ability to anticipate the future. While limits are obvious regarding the ability of any organization to accurately forecast the future, policy-oriented budgeting systems allow for the orientation of the budgeting process to become forward, not the current year or backward.

First, they are complicated and require much support, both moral and

* All the web addresses given in bibliography.

otherwise from management. It takes time for the newly introduced system to educate, recruit, and train the necessary policy generalists and budget analysts capable of running such a system. This maturation of such a complex system does not follow election cycles or other formal time lines. It is difficult and may well be impossible in some areas of government activity to develop performance goals, objectives, and measures that make sense: If it is difficult to measure, then it will be difficult to accurately incorporate that part of the government in a policy-based budget decision system. The measurement problem is somewhat fundamental and has been widely cited in the literature as a criticism of cost-benefit analysis. Such analysis is closely related to performance measures, and similar difficulties exist. It is difficult to quantify or value certain government activities.

Wildavsky (and to some degree Wildavsky and Pressman in their evaluation research) makes the point in "Rescuing Policy Analysis from PPBS" that policy analysis, in and of itself, is difficult enough when applied to limited areas. It is further weakened when it is applied government-wide and on a system of deadlines intended to be used to ultimately authorize a budget. This criticism must be placed in its appropriate historic context (and his views at the time toward incrementalism), but its essence remains a valid concern. Schick argued that the demise of PPBS was due, in part, to unrealistic expectations, unrealistic time lines for implementation, and its wide spread application, too soon.

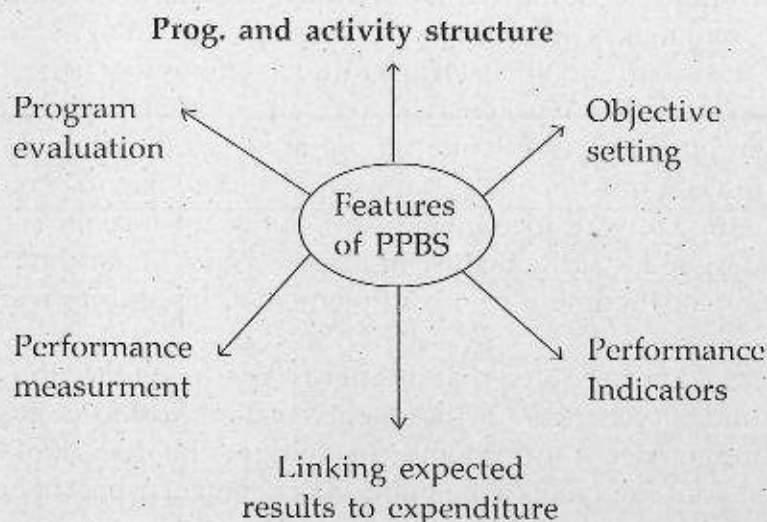
However, Caiden has noted that it is necessary to embrace the advances in technology and the changes in the quality of the workforce to redesign policy-based budget decision systems. As budget theorists look forward toward continued development of the public management aspect of budgeting, such issues will come to the forefront. The advent of Drucker's knowledge society and the development of Warren Bennis's "organizations of the future" provide us with a useful framework (and practical reasons) to improve the success of policy-based budget decision-making systems.

New computer technologies and highly centralized/decentralized computer and information networks can better enable the staff of central, executive budget agencies to develop realistic measures of performance. This type of analysis could even become "transparent" to the line agencies as each on-line budget and agency performance data becomes a virtual data base for the application of sophisticated technology-based performance evaluation techniques. If the new technologies are properly harnessed and if the corresponding budgeting systems are properly designed, then appropriate

functions can be centralized while others decentralized.

PPBS is in effect on integrating of a number of techniques in a planning and budgeting process for identifying, costing and assigning a complexity of resources for establishing priorities and strategies in a major program and for forecasting costs, expenditure and achievements within the immediate financial year or over a longer period.

United States Department of Defense leaders use their Planning, Programming, and Budgeting System to link operational requirements with financial obligations. Department of Defense branches typically divide the process into plans, programs and budgets. While planning, programming, and budgeting continues throughout the year, PPBS dictates a sequential and annual process culminating with annual Defense Plan, followed by a Defense Program, then a Defense Budget.



The existence of the new technologies are also providing a different kind of worker. These workers are better educated in general, and are the most "technology-able" workforce mankind has ever produced. The early "failures" of policy-oriented budgeting systems such as **PPBS**, **PERT**, **MBO**, and **ZZB** may, in large part, rest on the (in)ability of the workforce in general to use such sophisticated technology. Most of the "whiz kids" of the era located in and operating out of highly centralized offices using "magical" new techniques and technologies. This served to effectively separate them from the users and implementers of these highly complex systems.

Bounded rationality exists, as do constraints of time, space, and interest. However, the sophisticated computer systems and technology proficient work

force of the late 20th century have the potential to expand any individual or institutional "bounded rationality" to a point never before experienced by public manager. These expert systems and quality employees will also design user friendly systems that do not require the investment of the early systems to obtain answers about performance or goals. This will increase the acceptance and usefulness of these policy-oriented budgeting systems.

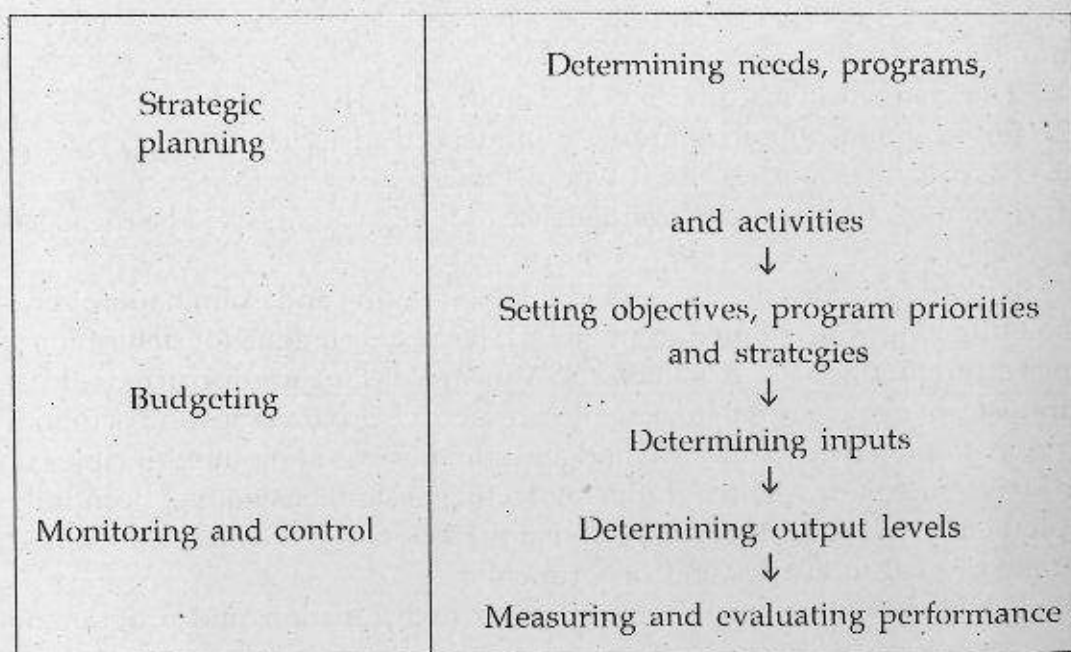
2.3 □ Zero-Base Budgeting

The idea of ZBB was given by Peter Plyrr in 1970. The first person to adopt was Jimmy Carter in 1973 when he was governed to GEORGIA. When he became president of USA in 1979, he introduced ZBB. Under ZBB no base or minimum expenditure level is presumed for any activity. ZBB means the past is cut off and the present is regarded as a clean state and all departments have to start from a scratch. It is also called Sunset Budgeting.

Difference between Conventional Budget and Zero Based Budgeting-

1. Base is always presumed. In ZBB the base is regarded as Zero.
2. All the department submits their budget of finance ministry. FM uses to present the budget in the collective manner. Every department has to present the budget independently. Accountability increases.

The PPBS Framework



PPBS seeks to achieve the twin objectives of results orientation and forging the input-output link through the following features:

- Program and activity structure;
- Objective setting;
- Performance indicators and budgeting by planned performance levels;
- Linking expected results to expenditure
- Performance measurement and reporting; and
- Program Evaluation.

3. There is only one time assessment of the budget that is at the time of the presentation of budget. Every time the assessment is made, one can easily cut down the expenditure if it is increasing and can be shifted to other head if it is becoming non-productive.

4. Even with a department the whole activity is combined and then the budget is being given to Finance Ministry. It is not only made department wise but section wise.

5. Even the priority sector cannot be immediately determined.

Therefore, ZBB has essential all the three advantages.

- A. Whether to spend?
- B. How much to spend?
- C. Where to spend?

Limitations of ZBB.

1. The charged items can't be calculated.
2. Subsidy and populism are very influenced in India.
3. Bureaucratic hurdles. As it would indicate their performance.
4. Defense, law and order maintenance of foreign affairs can't be managed easily.

Following a considerable period of investigation and examination, zero-base budgeting was adopted in India in 1986 as a technique for determining expenditure budgets. Accordingly the Ministry of Finance instructed all the administrative ministries to review their respective programmes and activities in order to prepare expenditure budget estimates based on the principles of zero-base budgeting. Although this budgeting system has not yet been fully implemented in India, it is envisaged that the following essential steps should be taken by all ministries and departments:

- (i) Establishment of precise objectives for each function, and programme or project;

- (ii) Identification and analysis of decision units,
- (iii) Formulation of decision packages; and
- (iv) Ranking of decision packages.

There has been some resistance by ministries and departments to the full implementation of zero-base budgeting. However a much more stringent degree of scrutiny and cost benefit analysis with clear prioritization of activities and programmes will have to be done if budgetary imbalances are not to be allowed to go beyond control.

2.4 □ Bibliography

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Module-II ● Unit-3 □ Public Goods

Structure

- 3.0 Introduction
- 3.1 Definition of Public Goods
- 3.2 Types of Goods
- 3.3 Theories of Public Goods
 - 3.3.1 The Normative Theory of Public Goods
 - 3.3.2 The Positive Theory of Public Goods Supply
 - 3.3.3 Concluding Observations
- 3.4 The Free Rider Problem
 - 3.4.1 Possible Solutions to The Free Rider Problem
- 3.5 Cost-Benefit Analysis (CBA)

3.0 □ Introduction

Public finance is now an exciting field of scholarship for a very simple reason. Scholars have only recently begun to look at fiscal phenomena through a different perspective. New insights are appearing. New relationships are being derived; old and established institutions and ideas are being subjected to critical analysis. Paradigms have not yet emerged to fix irrevocably the thought patterns of professionals. The theory of public goods remains in a preparadigm stage of development.

In the early and mid-nineteenth century when laissez-faire served as an intellectual model for social order, almost no intellectual historians designed a theory of public goods to parcel the development of the theory of private goods. There was rather a drive from socialist reformist thinkers in all its varieties to think for a shift of goods from private or market organization to public or governmental-political organization.

In the political sphere, no attempt was made to relate outcomes to individual values, and policy analysis proceeded on the possibility of assumption of benevolent despotism. This policy presumption was maintained, even when history witnessed the extension of suffrage at least apparently to everyone. From the neoclassical English utilitarians to the absolute individualist thinkers, no body fostered notions of 'public good' in political theory.

Socialist and nonsocialist scholars alike tended to accept the dichotomy between the public and the private sectors of the economy. Socialist proposals aimed at shifting the private production of private goods to collective management. Few questions were raised about "public" supply of "public" goods, for the most part, those which had been collectivized from the outset. This sector was not, presumably, subject to economic analysis; it received little attention from socialists or nonsocialists. In this sector, decisions were presumed to be made "politically" and not to be subjected to the analysis applied to decisions on the demand and supply of private goods, whether these should be provided in markets or by governments.

These comments are fully applicable only to the English-American tradition. Continental scholars like Wicksell, however, dominates the scene and he remains the intellectual father of modern public-finance theory. He tried to link the economics of public finance to the actualities of democratic process, at least a half-century in advance of his professional colleagues. The Italian scholars, like Francesco Ferrara, who wrote in the 1850s and 1860s, proceeded in the same way, though with lesser precision. Mazzola, Pantaleoni, de Viti de Marco, Einaudi, Barone, Fasiani are a few of the outstanding names in Italian tradition who stressed on a recognition of the productivity of public services to individuals,—on the identity of the producers and consumers public services—in an effectively democratic model, and on the cold realities of exploitation through governmental-fiscal processes. These scholars were almost wholly ignored by the followers of utilitarian pleasure-machines. German scholar Sax also mentioned about "public" goods, although his ambiguities concerning collective wants tend to overwhelm the real insights, that he possessed. Finally, the Swedes scholar Erik Lindahl, who, although was influenced by Wicksell, tended to concentrate attention unduly on the bargained solution to the public-goods problem and to shift attention away from the political-economic relationship properly stressed by Wicksell.

Public-finance economists were ignored because of their lack of understanding of the whole political process. They remained unconcerned with the way fiscal decisions actually get made, and they were apparently quite willing to define the whole expenditure side of the budget as being outside the pale of their analysis. It is but small wonder that little progress was made toward either an acceptable normative theory or a positive predictive theory of public finance until near the close of the interwar period.

Musgrave's discussion of Lindahl's model, along with Howard Bowen's

examination of voting and resource allocation, mark the beginnings of the modern era. These contributions were supplemented and the scope of theory expanded by Paul Samuelson's rigorous formulations of the efficiency conditions in his 1954 and 1955 papers. Wicksell was made available to English-language scholars in translation only 1958, along with other important continental writers. Only since then we have begun to witness a flowering of interest in public-goods theory, generally, and this interest has not yet reached its zenith.

In economics, a public goods is a goods that is non-rival. This means: consumption of the goods by one individual does not reduce the amount of the goods available for consumption by others.' For example, if /one individual eats a cake, there is no cake left for anyone else; but breathing air or drinking water from a stream does not significantly reduce the amount of air or water available to others.

The term *public goods* is often used to refer to goods that are non-excludable as well as *non-rival*. This means it is not possible to exclude individuals from the good's consumption. Fresh air may be considered a public goods as it is not generally possible to prevent people from breathing it. However, technically speaking such goods should be called pure public goods. These are highly theoretical definitions: in the real world there may be no such thing as an absolutely non-rival or non-excludable goods; but economists think that some goods in the real world approximate closely enough for these concepts to be meaningful.

Non-rivalness and non-excludability may cause problems for the production of such goods. Specifically, some economists have argued that they may lead to instances of market failure, where uncoordinated

markets are unable to provide these goods in desired quantities. These issues are known as *public goods problems*, and there is a goods deal of debate and literature on how significant they are, and on what their solutions might be. These debates can become important to political arguments about the role of markets in the economy. More technically, public goods problems are related to the broader issue of externalities.

3.1 □ Definition of Public Goods

Paul A. Samuelson is usually credited as the first economist to develop the theory of public goods. In his classic 1954 paper *The Pure Theory of Public Expenditure* he defined a public goods, or as he called it in the paper a

"collective consumption goods", as follows: '...[goods] which all enjoy in common in the sense that each individual's consumption of such a good leads to no subtractions from any other individual's consumption of that good...'

This is the property that has become known as Non-rivalness. In addition a pure public goods exhibits a second property called Non-excludability: that is, it is impossible to exclude any individuals from consuming the goods.

The opposite of a public goods is a private good, which does not possess these properties. A loaf of bread, for example, is a private goods: its owner can exclude others from using it, and once it has been consumed, it cannot be used again.

A goods which is rival but non-excludable is sometimes called a common pool resource. Such goods raise similar issues to public goods: the mirror to the public goods problem for this case is sometimes called the tragedy of the commons. For example, it is so difficult to police deep sea fishing that the world's fish stocks can be seen as a non-excludable resource, but one which is finite and diminishing.

It should be emphasised that these concepts are highly theoretical. For example, the definition of non-excludability states that it is impossible to exclude individuals from consumption. In reality, perhaps any ----- can become excludable: for example, radio or television broadcasts have in the past been used as a classic example of non-excludable goods. But as technology has developed, it is now possible to encrypt these signals so that anyone without a special decoder is excluded from the broadcast.

Many forms of creative works have characteristics of public goods. For example, a poem can be read by many people without reducing the consumption of that goods by others; in this sense, it is non-rival. Similarly, the information in most patents can be used by any party without reducing consumption of that goods by others. Creative works may be excludable in some circumstances, however: the individual who wrote the poem may decline to share it with others by not publishing it. Copyrights and patents function to encourage the creation of such non-rival goods by providing temporary monopolies, or, in the terminology of public goods, providing a legal mechanism to enforce excludability for a limited period. For public goods, the "lost revenue" of the producer of the goods is not part of the definition: a public goods is a good whose consumption does not reduce any other's consumption of that goods.

	Excludable	Non-excludable
Rivalrous	Private goods food, clothing, toys, furniture, cars	Common pool resources water, fish, hunting game
Non-rivalrous	Club goods cable television	Public goods national defense, terrestrial television

Private and Public Goods

As well as public goods there can be public bads that have negative externality effects instead of positive ones. For example, pollution or political corruption may be bads that show some of the same non-excludability and non-rivalness properties.

The economic concept of public goods should not be confused with the expression "the public goods", which is usually an application of a collective ethical notion of "the goods" in political decision-making. Another common confusion is that public goods are goods provided by the public sector. Although it is often the case that Government is involved in producing public goods, this is not necessarily the case. Public goods may be *naturally* available, they may be produced by private individuals and firms, by non-state collective action, or they may not be produced at all.

The theoretical concept of public goods does not distinguish with regards to the geographical region in which a goods may be produced or consumed. However some theorists use the term **global public goods** to mean a public goods which is non-rival and non-excludable throughout the whole world, as opposed to a public goods which exists in just one national area. Knowledge is held to be an example of a global public goods.

Collective goods (or social goods) are often defined as public goods that could be delivered as private goods, but are usually delivered by the government for various reasons, including social policy, and financed from public funds like taxes.

3.2 □ Types goods

Goods may be of various kinds: public goods - private goods - common goods - common-pool resource-club goods - anti-rival goods, rivalrous goods

and non-excludable goods. It may be clarified as complement goods vs. substitute goods -free goods vs. scarce goods, positional goods, (non-)durable goods, intermediate goods (*producer good*), final goods, consumer goods, capital goods, inferior goods, normal goods, ordinary goods, luxury good, superior goods search goods, (post-) experience goods, merit credence goods, demerit goods etc.

Areas of Public Goods

Common areas of public goods include: defense and law enforcement (including the system of property rights), public fireworks, lighthouses, clean air and other environmental goods, and information goods, such as software development, authorship, and invention. Some goods -such as orphan drugs- require special governmental incentives to be produced, but can't be classified as public goods since they don't the above requirements (Non-excludable and non-rivalrous.)

The provision of a lighthouse has often been used as the standard example of a public goods, since it is difficult to exclude ships from using its services and no ship's use detracts from that of others. However, since most of the benefit of a lighthouse accrues to ships using particular ports, lighthouse maintenance fees can often profitably be bundled with port fees (Ronald Coase, *The Lighthouse in Economics* 1974). This has been sufficient to fund actual lighthouses.

A public good's status may change over time. Technological progress can significantly impact excludability of traditional public goods: encryption allows broadcasters to sell individual access to their programming. The costs for electronic road pricing have fallen dramatically, paving the way for detailed billing based on actual use. On the other hand, technological progress can also create new public goods. The simplest examples are street lights: they are relatively recent inventions (by historical standards), one person's enjoyment of them does not detract from other persons' enjoyment, and it is impossible to charge individuals separately for the amount of light they presumably use.

Note: Some writers have used the term public goods to refer only to non-excludable pure public goods. They may then call excludable public goods club goods.

3.3 □ Theories of Public Goods

3.3.1 The Normative Theory of Public Goods

Normative and positive strands are closely intermingled in the modern theory of public goods. The normative theory of public goods, best represented in the two basic papers by Samuelson, stems directly from theoretical welfare economics. This subdiscipline is widely acknowledged to be normative in that its allocative norms prescribe the ends or "shoulds" of policy, provided that efficiency criteria are accepted. These norms are, of course, much more carefully circumscribed than were those of the old welfare economics. The formal structure of the new version was developed only in the 1930s and 1940s, although the intellectual origins lie in the work of Pareto. Pareto searched for more rigorous criteria for making policy statements on the basis of the norms for optimality or efficiency. This set of norms allowed economists to classify positions, or proposals for changes in positions, into two separate categories: optimal (efficient) and nonoptimal (inefficient). This classification is accomplished with minimal ethical commitment, and the commitment that is required is such as to command near-universal consent.

In a formal sense, the Pareto constructions were highly useful, and remain so, but economists were not fully satisfied with the formal limits. They sought to find more direct application, and this search produced its own exhausting and long-continuing discussion of compensation. This led, in its turn, to the attempts to formulate a "social welfare function," a fictional device that draws attention away from the explicit resort to external and non individualistic criteria.

In proper concern of the normative theory of public goods is limited to laying down the necessary original conditions for the allocation of resources to public-goods supply. Multiple outcomes are possible, each of which will satisfy the conditions for efficiency, but the role of the analysis in this normative version is not that of making a specific selection from among these outcomes. Rather its role is that of providing the formal classification scheme that allows the analyst to place all possible outcomes into one of the two sets.

Both Samuelson and Musgrave fail to sense what to me seems to be the basic contradiction between the social welfare function approach and the use of Pareto criteria. Samuelson defines the necessary conditions for allocative efficiency with respect to public goods, but after having done so, he then resorts to a social welfare function to select the single best state of the world. It is

impossible, of course, to isolate the allocative problem from the distributional one, since the sharing of the inframarginal gains-from-trade as well as the initial position will determine allocative outcomes through the operation of income-effect feedbacks. Conceptually, however, the normative theory should end with its formal statement of the necessary conditions that must be met. Musgrave follows a pattern similar to Samuelson's when he conceptually separates the allocation and distribution functions of the budget. It is difficult to understand the logic of this segmentation if a consistent analytical model is desired considering the inherent contradiction between the problems to resolve distributional issues and the question of relying on norms based exclusively on individual preference orderings. The distribution will, in itself, have feedback effects on allocative outcomes. Much of orthodox economic theory is normative in the sense that these are oriented to providing "government" with "advice" about efficient resource allocation. The contrast between "normative" and "positive" theory is between two sets of objective analysis, the first aimed primarily at specifying precisely the characteristics of results that "should" be aimed for in governmental action on the presumption that efficiency is desired and the second aimed primarily at *explaining* and *predicting* the outcomes of collective decision processes involving the participation of many persons. The possibility of separating these two strands of analysis is greater in the theory of public goods than in the theory of private goods, the analysis of markets. In the latter, thorough analysis of the necessary conditions that must be satisfied for overall allocative efficiency carries with it a parallel analysis of the interaction processes through which the voluntary exchange behavior of individuals produces efficient outcomes, given that the familiar set of side conditions is also met. Micro-economic theory becomes at one and the same time a normative theory of public policy to the extent that efficiency objectives are paramount, and a positive theory of market interaction. In the former, the theory conceptually tells the government what conditions should be satisfied; in the latter, the theory predicts the results that will tend to emerge.

The normative theory states the necessary conditions that should be met if the relevant decision makers accept overall efficiency criteria. It does not contain in the process an explanation or prediction about the voluntary interaction of individuals operating to meet these conditions. Quite the opposite; the theory more or less directly implies the positive statement that these voluntary interactions will not meet 'efficiency requirements, even in some acceptably proximate sense. In other words, the normative theory of

public finance contains a positive statement about "market failure" in the presence of public goods. It stops short of analyzing the institutional processes that might be required to generate efficient outcomes.

3.3.2 The positive Theory of Public- Goods Supply

A positive theory of public finance must begin with the basic efficiency analysis that is contained in the standard normative theory. In addition, it must incorporate the negative result that wholly voluntary behavior of individuals in exchange may not produce outcomes satisfying allocative efficiency requirements. Beyond these essentials, a positive theory must analyze the behavior of persons as they examine organizational alternatives to markets, along with their behavior as they participate in collective decision processes that may be designed to secure mutual gains-from-trade in public goods.

The possible failure of voluntary exchange or market mechanisms to generate efficient outcomes arises because of the large-number setting in which individuals find themselves. The free-rider dilemma expresses this critical feature. Despite the presence of this dilemma, however, there exist mutual gains-from-trade in public goods and services, and these motivate individuals to seek agreements or changes in the rules governing behavior, even if there is no incentive for them to engage in person-to-person bilateral exchanges of the ordinary sort. Before such generalized agreements can be properly analyzed on their own account, small-number models may be introduced provided that these are interpreted as useful analogues to large-number models. The models show that, in the absence of the large-number problem, efficient outcomes will tend to emerge from voluntary-exchange processes. Through these models the theory of public-goods supply is placed in a position roughly comparable to the theory of private goods which, in this respect, remains always in small-number settings.

The models of bilateral (and later of trilateral) trade or agreement on the supply and financing of public goods are not intended to explain real-world fiscal structures. They should be considered as demonstrations of the pressures that mutual gains-from-trade will exert on persons, who will on the basis of their own preferences, organize "public-goods trades," save as they are prevented from so doing by the large-number dilemma. In this particular aspect, the bilateral models developed by Lindahl, although they are formally similar to those developed in this book, seem to have been misinterpreted, even by some of their expositors. These models should never have been aimed at

explaining how voluntary exchange might lead to efficient outcomes in the presence of public-goods phenomena. Properly interpreted, they show how and why efficient outcomes will emerge, given public-goods phenomena, *in the absence of the large-number dilemma*. In this context, the small-number models represent helpful abstractions in a whole chain of related theoretical reasoning. Much of the criticism of the Lindahl-type models has concentrated on the bargaining or strategic-behavior difficulties encountered in small-number interactions. The primary task of theory is to explain behavior in the presence of public-goods phenomena over large-number groups. Here, the small-number models should, and must, abstract from the specific characteristics of behavior that arise only in small-number interactions. If they do not do this, these models can be of no use in explaining the large-number models that must finally be developed.

The simple trading models demonstrate only that efficient outcomes will tend to emerge in the extremely rarefied conditions imposed. If the number of persons is small, and if they behave *vis-a-vis* other persons as if they are in large-number circumstances, ordinary exchange will generate outcomes that may be classified as optimal. The free-rider analysis, following hard on these trading models, demonstrates that the extension of numbers is sufficient to eliminate the optimality properties of predicted trading outcomes. The next stage of a positive theory is apparent. Individuals, recognizing the failure of voluntary-exchange organization, but also continuing to recognize the presence of mutual gains-from-trade in public goods, may propose "rules changes" that will so modify the conditions for individual choice as to secure at least some if not all of the gains-from-trade that are promised. This stage involves the logical derivation of "fiscal systems" as a part of the whole political order from the basic preference orderings of individuals.

The "constitutional rules" that describe the fiscal system must include rules concerning the making of budgetary choices in all aspects. These must include rules for deciding among alternative proposals that might be presented, rules for selecting which goods and services are to be supplied publicly rather than privately, rules for determining the characteristics and the extent of provision for those goods and services that are to be privately supplied, and, finally, rules for allocating the costs of these publicly supplied goods and services among individuals and groups in the whole community.

The mere enumeration of these different sets of rules or institutions suggests the magnitude of the task required before the construction of any

complete positive theory. The simple efficiency norms provided by the orthodox Pareto criteria are no longer directly applicable. At another level, efficiency criteria can be evoked, as suggested in some of the earlier discussion, but these are more complex. An extension of Pareto criteria to the predicted operation of rules or institutions becomes possible, and, in one sense, the standard normative theory of public goods can be extended in this manner. This extension goes beyond the problems of determining how much and which public goods should be supplied and moves toward the problems of determining which set of fiscal institutions should be selected. The extended normative theory involves the discussion of the optimal or efficient fiscal constitution.

This extension of theory to the analysis of alternative rules or institutions is more natural in a positive than in a normative approach. In the former, the extension of analysis to the problems of choice among rules becomes an essential follow-on stage. With the normative theorist, having completed his derivation of the required efficiency conditions, there is the underlying presumption that the collectivity, the government, will somehow implement his implied recommendations, or, at the, least, will take these into account in the policy mix that it does finally select. With the positive theorist, there is no such underlying presumption since the collectivity simply does not exist apart from the individuals that make up the community. Collective action must be "explained" and "understood" through individual behavior.

There are two separate parts of this institutional stage of a positive theory of public finance. The first consists in the development of a logical theory of individual choice among alternative institutions. This is closely akin to the economist's standard theory of individual choice, and it creates no conceptual difficulties. The procedure here is one of examining the choice among alternative institutional structures in terms of an individual decision calculus.

The second part of a theory of institutional choice, as an integral part of a positive theory of public finance, is essentially empirical. Perceptive observations of real-world fiscal structures are needed, and the analyst must try to isolate the central elements in such structures that serve best to explain and predict. Conceptually, models of real-world institutions can be tested; hypotheses can be refuted, and, in turn, different hypotheses can be suggested. Painstaking accumulation of the record of historical experience, careful presentation of descriptive detail, and comparative analysis: these are all necessary.

3.3.3 Concluding Observations

There seems to be no need for a normative-positive clash on methodological principle. The normatively oriented economist who remains within the Pareto-efficiency framework and who is willing to stretch his constructions beyond their normal limits can be of great assistance to his positivist counterpart who /explicitly rejects global efficiency criteria and seeks to predict the results of individual behavior in institutional constraints. The distinction between these two need not lie in the particulars of analysis; the distinction lies instead in the somewhat greater willingness of the normativist to stop short of foil explanation, to consider his strict role as "economist" finished once he has completed what, to the positivist "political economist," seems only a part of the job.

The theory of "The Demand and Supply of Public Goods" remains in a preparadigm stage of development. Also for this reason, no single treatment or presentation is likely to command universal assent among informed scholars nor is it likely to be free of its own ambiguities, confusions and contradictions.

3.4 □ The Free Rider Problem

Public goods provide a very important example of market failure, in which market-like behavior of individual gain-seeking does not produce efficient results. The production of public goods results in positive externalities which are not remunerated. Because no private organisation can reap all the benefits of a public good which they have produced, there will be insufficient incentives to produce it voluntarily. Consumers can take advantage of public goods without contributing sufficiently to their creation. This is called the free rider problem, or occasionally, the "easy rider problem" (because consumer's contributions will be small but non-zero).

For example, national defense is a standard example of a pure public good. A purely rational person (also known as *homo economicus*) is an individual who is extremely individualistic, considering only his own benefits and costs that directly affect him or her. Public goods give such a person incentive to be a free rider. A purely rational thought about exerting some extra effort to defend the nation provide the individuals with very low benefits, since the benefits would be distributed among all of the millions of other people in the country. Further, there is a very high possibility that he could get injured or killed during the course of his or her military service.

On the other hand, the free rider knows that he or she cannot be excluded from the benefits of national defense, regardless of whether he or she contributes to it. There is also no way that these benefits can be split up and distributed as individual parcels to people. So the free rider would not voluntarily exert any extra effort, unless there is some inherent pleasure or material reward for doing so or a legal compulsion.

3.4.1 Possible Solutions to The Free Rider Problem

Dominant Assurance Contracts

Assurance contracts are contracts in which participants make a binding pledge to contribute to a contract for building a public good, contingent on a quorum of a predetermined size being reached. Otherwise their money is refunded.

● Coasian Solution

The *coasian solution*, named for the economist Ronald Coase and unrelated to the Coase theorem, proposes a mechanism by which potential beneficiaries of a public good band together and pool their resources based on their willingness to pay to create the public good. Coase (1960) argued that if the transaction costs between potential beneficiaries of a public good are sufficiently low, and it is therefore easy for beneficiaries to find each other and pool their money based on the public good's value to them, then an adequate level of public goods production can occur even under competitive free market conditions.

A similar alternative for arranging funders of public goods production is to produce the public good but refuse to release it into the public until some form of payment to cover costs is met. This method of public goods production is a modern application of the street performer protocol for public goods production.

In some ways, the formation of governments and government-like communities such as homeowners associations can be thought of as applied instances of practicing the Coasian solution by creating institutions to reduce the transaction costs.

Government Provision

If voluntary provision of public goods will not work, then the obvious solution is making their provision involuntary. One general solution to the problem is for governments or states to impose taxation to fund the production of public goods. The difficulty is to determine how much funding should be allocated to different public goods, and how the costs should be split.

● **Subsidies**

A government may subsidize production of a public goods in the private sector. Unlike government provision, subsidies may result in some form of competitive market. Depending on the nature of a public good and a related subsidy, principal agent problems can arise between the citizens and the government or between the government and the subsidized producers; this effect and counter-measures taken to address it can diminish the benefits of the subsidy. Subsidies can also be used in areas with a potential for non-individualism: For instance, a state may subsidize devices to reduce air pollution and appeal to citizens to cover the remaining costs.

● **Legislated Exclusion**

Another solution, which has evolved for information goods, is to create intellectual property laws, such as copyright or patents, covering the public goods. These laws attempt to remove the natural non-excludability by prohibiting reproduction of the good. Although they can solve the free rider problem, the downside of these laws is that they imply private monopoly power and thus are not Pareto-optimal.

● **Public Spirit**

If enough people do not think like free-riders, the private and voluntary provision of public goods may be successful. A free rider might litter in a public park, but a more public-spirited individual would not do so, getting an inherent pleasure from helping the community. In fact, a public-spirited person might voluntarily pick up some of the existing litter. If enough people do so, the role of the state in using taxes to hire professional maintenance crews is reduced. This might imply that even someone typically inclined to

free-riding would not litter, since their action would have such an obvious cost.

Public spirit may be encouraged by non-market solutions to the economic problem, such as tradition and social norms. For example, this kind of public spirit involving concepts such as nationalism and patriotism has been part of most successful war efforts, complementing the roles of taxation and ascription. Regardless of the method of providing public goods, the efficient level of such provision is still being subjected to economic analysis. For instance, the Samuelson condition calculates the efficient level of public goods production to be where the ratio of the marginal social cost of public and private goods production equals the ratio of the marginal social benefit of public and private goods production.

3.5 □ Cost-Benefit Analysis (CBA)

Project evaluation is the most specialized planning which involves systematic, objective and comprehensive appraisal of development programmes for individual commodities and projects. It implies an appraisal or assessment of a project as to its operational efficiency technically, economically, financially and managerially. It involves a probe by a group of outside experts in to the working of a project, to find out its achievements and weaknesses, and to suggest ways and means of overcoming the weaknesses to improve its operation. Project "evaluation thus refers to the procedures of fact-finding about the results of planned social action which in turn move the spiral of planning over upward, it is the proper methodological accompaniment."

Project evaluation is an integral part of any development programme in order to assess its success or failure and to point out further lines of improvement, it is a process to evaluate the rate of return on a project, its social profitability and its side effects on the growth rate of population, on employment, industry and management training and on rate of reinvestment. Further, it helps to assess the impact of the new project on the people of the area especially on their social and economic conditions. "Evaluation is, therefore, an essential aid to policy, it may be considered to be a branch of research which is oriented primarily to the needs of an action programme." "Project evaluation utilizes principles similar to those which govern the evaluation of industrial sectors, but it requires more extensive study of individual elements.

Whereas sector analysis is applied only to the topical cost and demand conditions in the industry, project analysis takes into account a variety of supply and demand factors.

It involves four stages; to make appraisal when the project is in operation in order to find out how much has been accomplished and what remains to be accomplished, to suggest ways and means to improve its operation further and to plug loopholes; and lastly, to evaluate the ends achieved by the project when it is complete and is in complete and is in full operation.

In the methods of project evaluation, the usual stages are: (a) the description of the technical and economic characteristics of each project; (b) the estimation of the influence of the project on the economy, both during the construction period as well as during the operational period, when the investment is completed and the newly productive capacity is in operation; (c) the evaluation of the consequences of the project which may be direct or indirect. The direct effects consist of the immediate contributions to production within the sector of the project while the indirect effects are those in sectors vertically connected with the sector, either preceding or following, because of their direct technological links; and (d) the formulation of the criterion for the selection of the projects.

In appraising projects from the national viewpoint the most appropriate and popular method is the most scientific and useful criterion for project evaluation, it helps the planning authority in making correct investment decisions to achieve optimum resource allocation by maximizing the difference between the present value of benefits and costs of a project, it involves the enumeration, comparison and evaluation of benefits and costs. This implies weighing of the returns against the costs involved in a project. Thus the cost-benefit analysis "purposes to describe and quantify - the social advantages and disadvantage of a policy in terms of a common monetary unit. Its objective function is the establishment of the social benefit. This objective function can be expressed as $NSB = \text{Benefit} - \text{Costs}$, where benefits and costs are measures in terms of 'shadow' or 'accounting' prices of inputs and outputs instead of in actual market prices.

The formula $B-C/I$ is "for determining the total annual returns on a particular investment to the economy as a whole irrespective of to whom these accrue." Here I does not include the private investment that may have

to be incurred by the beneficiaries of the project, such as the cultivators for an irrigation project. If the private investment happens to be very large, even a high value of $B-C/I$ may be less beneficial to the economy. Thus, this criterion would not give satisfactory results. The adoption of the $B-C$ criterion would always favor a larger project, and make small and medium size projects less beneficial. Thus the criterion can only help in determining the scale of the project on the basis of the maximization of these differences between B and C .

But the best and the most reliable criterion for project evaluation is B/C . In this criterion, the benefit-cost ratio is the measure for the evaluation of a project. If $B/C=1$, the project is marginal. It is just covering its costs. If $B/C>1$, the benefits are more than costs and it is beneficial to undertake the project. If $B/C<1$, the benefits are less than costs and the project cannot be undertaken. The higher the benefit-cost ratio, the higher will be the priority attached to a project. Since capital and other scarce resources are scarce in underdeveloped countries, it can maximize output by using them on a project so that its benefit-cost ratio is higher than that of the next alternative project.

The above formula does not take into account the 'time horizon' of the project. As a matter of fact, future benefits and costs cannot be treated at par with present benefits and costs. Therefore, the appraisal rules for project evaluation require discounting of future benefits and costs because society prefers the present to the future. For this purpose, economists have devised a number of 'decision rules' or criteria. But we shall confine ourselves to these present value criterion and the internal rate of return criterion.

It is an important criterion used for project evaluation. Net Present Value (NPV) is equal to the present values of benefits minus the present value of operating and maintenance costs minus initial outlay. This criterion is also expressed as the net present value of benefits criterion so that $\text{Net Present Value of Benefits} = \text{Gross Present Value of Benefits} - \text{Gross Present Value of Costs}$. A project is socially profitable, if the $\text{NPV} > 0$. If there are a number of mutually exclusive projects, the project with the highest net present value of benefits will be chosen.

But the explanation of the NPV criterion in terms of benefits and costs is not a correct method for project evaluation because it neglects the time horizon. Capital investments give benefits after a lapse of some time. Therefore,

future benefits and costs cannot be equated with present benefits and costs. Since society gives preference to the present over the future, it becomes essential to discount future benefits and costs of projects.

CBA is a life cycle analysis of both the costs and benefits associated with a project.

CBA is usually associated with capital projects. Basic information needed for CBA:

- Measurement of all costs and benefits.
- Determination of the Net Present Value of all C & B.
- Assessment of the relationship between the costs & benefits.

Cost-Benefit Process

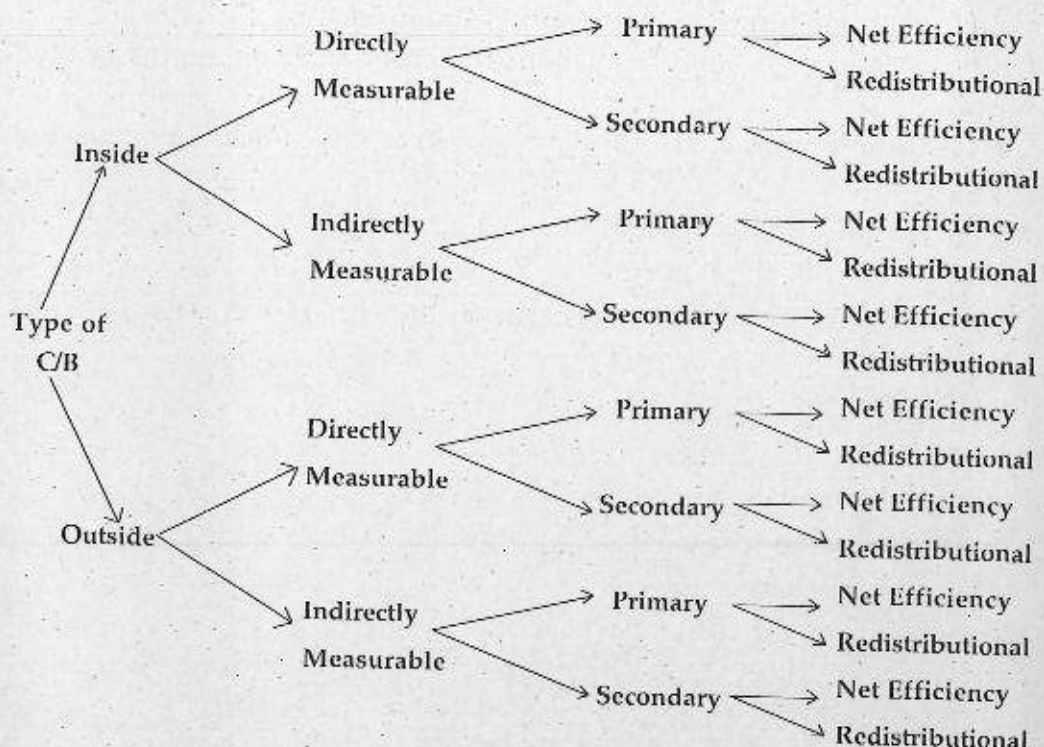
1. Specify objective.
2. Identify alternatives
3. Collect & analyze info.
4. Specification of target groups
5. Identification of all costs and benefits
6. Discount all C&B
7. Estimate risk & uncertainty
8. Specify criteria for selection

Steps 1-4 are the same as in the basic policy analysis process. Identification of all costs and benefits is a very complex undertaking. Use of classification schemes can assist in the identification process.

Identifying Costs/Benefits may be done by proceeding with four questions:

1. Is the C/B Internal or External to a target group?
2. Is the C/B Tangible or Intangible?
3. Is the C/B a direct or indirect result of the program?
4. Do the combined C&B create a real increase in utility or a pecuniary shift?

C/B Tree Structure



Essential Requirements for simple Cost-Benefit Process to respond to step 5:

All Real Costs & Benefits must be taken into account.

Pecuniary C&B (A tradeoff, where one person's cost is another's benefit.

Also termed redistributional C&B) must be excluded.

CBA should be limited to primary Costs & Benefits.

Variety of costs must be considered:

1. Capital costs
2. Maintenance & operating costs
3. Opportunity costs
4. Social costs—externalities

Many public-sector C & B are, however, not directly measurable. Shadow Pricing for CBA must be used this, it uses a surrogate measure because the Cost or Benefit cannot be measured directly.

Cost-Benefit Decisions may be taken by following two Choices :

1. Ratio of benefits to costs - used when multiple projects may be selected.

2. Absolute value of benefits over costs - used when trying to achieve maximum utility from selection of one option.

Decision Example

Project	Benefits	Costs	Ratio	Net
A	30	3	10	27
B	64	8	8	56
C	100	40	2.5	60

If multiple projects can be chosen, under a budget cap, choose multiple A's.

With no constraint, choose C.

● Risk Philosophies

1. High Risk philosophy - Marginal productivity of capital in private investment, kesuiis ui conservative investment rate.
2. Moderate philosophy - Social Rate of Time Preference. Compensation necessary to induce consumers to refrain from spending.
3. Low Risk Philosophy - Government borrowing rate without regard for time preference. Raie at which federal government is willing to borrow money.
4. felkihnax philosophy - internal Rate of Return. Rate at which C&B (Net Present Value) are equal.

● Strengths of Cost-Benefit

Both costs and benefits are measured in dollars as a common unit of value.

Allows us to go beyond the confines of a single policy or program and link C & B to society as a whole.

Allows direct comparison of programs in widely differing areas.

● Limitations of Cost-Benefit

Exclusive emphasis on economic efficiency excludes equity criteria.

Monetary value is an inadequate measure of responsiveness (e.g. Rs. 1,000 to a rich person and a poor person - value of money is relative.)

The frequent use of shadow prices may be arbitrary and unjustifiable.

The bottom line is subject to intentional manipulation to produce a pre-determined outcome.

□ COST-EFFECTIVENESS

Cost-Effectiveness Procedure maximizes value received for a given expenditure. This means not all benefits must be defined or measured; only key value is to be considered.

● Cost-Effectiveness Procedure

Steps 1 — 4 are the same as CBA

Step 5 — Choose a comparison value criterion (what is the value to be received, lives saved, etc.)

Step 6 — Calculate the value for each alternative proposed (to NET PRESENT VALUE).

Step 7 — Rank alternatives in terms of highest cost-effectiveness $C.E = \text{Value/Costs}$.

Step 8 — Recommendation

Cost-Effectiveness Advantages

- Less work than CBA
- More applicable to "suit" programs — can be used on non-capital projects
- Flexible

Reality-orientation : Effective decision-makers stay in close touch with such ministry realities as resource constraints, morale, team members' capabilities, and learning from mistakes. They have a good sense of what is realistic and unrealistic and how members of the ministry team perceive reality. Their intuition of tilings comes from frequent interaction with team members—from being plugged in to team activities and fluctuating workplace circumstances. "Management by walking around" is a recently coined phrase that aptly describes this in-touch reality-orientation process.

Cost-benefit analysis : Smart decision-makers not only stay in touch,

they have a knack for identifying which options will be most fruitful to pursue. This requires keen insight into the probable costs and benefits of action alternatives and an ability to make intelligent trade-offs between the two. Which costs are worth incurring to derive which benefits? Cost-benefit discernment lies With consulting ministry team members, who should always be the decision-maker's closest confidants and well informed about reality.

Timeliness: The third quality of smart decision-making is knowing when to make the decision. Both premature and procrastinated decisions can extract a heavy toll. Wise managers realize when more Information is needed to make a decision or when additional team consultation is warranted. They also know when the costs of analyzing a decision further outweigh the benefits. Timely decision-making is the product of experience and, once again, open-minded consultation with the ministry team.

Facts balanced with "feels": Decisions result from facts and "feels," but achieving the right balance is never easy. Some managers rely too much on facts while others over-rely on feelings. Both objective analysis and intuitive feel are involved in decision-making, even though some decision-making, even though some decisions are more "head" decisions than "heart" decisions. Whatever the nature of the decision, ministry managers must strive to blend intellect and intuition to achieve decision-making balance.

Incrementalism: Effective decision-makers learn most from acting in progressive increments—step by step, phase by phase. They resist the tendency to make important future decisions until receiving feedback on the results of related past decisions. Therefore, decisions are made in an interlocking sequence. Incrementalism thus explains why on-the-job experience promotes sound decision-making. Managers learn what works in the ministry and thus make their future decisions accordingly.

As economic and social intervention by governments has increased, the limitations of "Incrementalism" as a public administration practice have become increasingly apparent. Incrementalism is the tendency of government to tinker with policies rather than to question the value of continuing them. A number of techniques have been introduced to make decisions more rational. A selection of articles discussing this topic in related articles in Encyclopedia Britannica suggests that in analysis of government programs cost-benefit analysis is widely applied. This involves identifying, quantifying, and comparing the costs and benefits of alternative proposals. Another, less successful, technique was the **Planning Programming, and Budgeting System**

(PPBS), introduced into the U.S. Department of Defense in 1961 and extended to the federal budget in 1965. Cost-benefit analysis, sometimes identified with the nignniag—programming—budgetary system (PPBS), represents an effort to improve the planning of government expenditures. Stalling from the fact that public expenditures are not sensitive to the economic considerations of price and profitability but that they nevertheless use up scarce resources that have economic value, PPBS attempts to bring rational choice to the management of a defense budget coincided with the U.S. involvement in Vietnam. Terms such as systems analysis, as well as planning, programming, and budgeting systems (PPBS) and functional costing, became common in defense management. Much of the intellectual capital invested in these techniques came from economists, whose discipline in costing.

According to PPBS, the objectives of government programs were to be identified, and then alternative means of achieving these objectives were to be compared according to their costs and benefits. In practice, PPBS made little difference in federal budgeting, partly because the objectives of governmental programs were difficult to specify and partly because comprehensive evaluation took too long. PPBS was abandoned in 1971, and similar attempts, such as Management by Objectives and Zero-Base Budgeting, both introduced in the 1970s, were equally short-lived and ineffective. Comparable schemes in western Europe, such as the method called "rationalization of budgetary choice" introduced into France in the late 1960s and the so-called Programme Analysis and Review in Great Britain in the 1970s, were likewise unsuccessful.

Quantitative economic measurement is useful up to a certain point, but the value of human life, of freedom from sickness and pain, of safety on the streets, of clean air, and of opportunity for achievement are hardly measurable in monetary terms. Public administration has thus increasingly concerned itself with developing better social indicators, quantitative and qualitative—that is, better indexes of the effects of public programs and new techniques of social analysis.

Another development has been an increasing emphasis on **human relations**. This originated in the 1930s when what became known as the Hawthorne research, involving the workers and management of an industrial plant near Chicago, brought out the importance to productivity of social or informal organization, good communications, individual and group behaviour, and attitudes.

Awareness of the importance of human relations influenced the conduct of public administration. Many shibboleths of administration (hierarchy, directive leadership, set duties, treatment of employees as impersonal "Units" of production, and monetary incentives) were challenged.

By the late 1930s the human relations approach had developed into a concept known as "organization development." Its primary goal was to eliaage the attitudes, values, and structures of organizations so that they could ineci new demands. Trained consultants, usually from outside the organization, undertook intensive interviewing of senior and junior staff, ana sensitivity training and confrontation meetings were also held. Unlike the rationalistic PPBS approach, organization development stressed the identification of personal with organizational goals, the "self-actualization" of workers and managers, eifective interpersonal commucation, and broad participation in decision making. Its direct use Within government agencies not been limited and has not always been successful, but it has had considerable indirect influence upon administrators.

Another modern movement in public administration has been the greater participation or citizens in goven. It was stimulated during the 1950s and '60s by a growing feeling that governments were not responding to the needs of their citizens, particaiariy minority groups and the poor. A variety of experiments to involve citizens or their representatives in making governmental deeciions were begun in the 1960s. These involved the delegation of decision making from centra! to local offices and, at the local level,, the sharing of authority with citizen groups.

A current of change is technology. The breakthroughs of an information-and-computer age are not only advancing globalization but are also recasting public policy and management. The impact is rapid and continually changing. On the educational side of public administration, most MPA programs have altered many facets of the educational enterprise accordingly. Not only are there courses exclusively devoted to inculcating expertise; but also many courses in, say, finance or budgeting, rely on computers and information systems in their pedagogy.

The field's historic preoccupation with rational, objective decision making revered information and analyses as essential tools of policymaking. Offices of evaluation legitimate the importance of basing policy in its formulation and implementation on exacting analysis. Technology not only facilitates that premise but also accelerates and disseminates it. Cost-benefit analyses,

queuing theories, and other modern techniques have especially refined policy in finance and in the delivery of many services like transportation, the deployment of the military, the location and scale of major investments in the infrastructure, the like.

But where technology portends some very fundamental shifts in how we conduct the public's business, is show. For-example, agencies still conform in structure and, to some degree, in behavior to the hierarchical, command-and-control models of the past; these tend to insure stability but they also engender rigidity, incrementalism, rule-bound decisions, and other dysfunctions. Technology, with its capacity to span time and space and with its rapidity of transmitting information promises, is the advent of new modes of organizing, decision making, implementing and evaluation. Greater reliance on teams, greater flexibility in organizing for work, greater capacity to coordinate across units and geography are yet to be acquired fruitfully; these manifestation's of change are slow to materialize against the preponderance of past practice. It is partly because of costs and privacy issues, this new technology is slow to revolutionize how government deals with people. That failure finds its costs in time-consuming and often redundant procedures, in the indignities sustained by clients, and in the inconsistencies across policies with respect to eligibility, certification, and service. This is but one example of just how hard change is even with the prospect of a path-breaking technology.

Notes :

1. For current definitions of public goods see any mainstream microeconomics textbook, eg.: Hal R. Varian, *Microeconomic Analysis* ISBN 0-393-95735-7; Mas-Colell, Whinston & Green, *Microeconomic Theory* ISBN 0-19-507340-1; or Gravelle & Rees, *Microeconomics* ISBN 0-582-40487-8.
2. Paul A. Samuelson (1954). "The Pure Theory of Public Expenditure". *Review of Economics and Statistics* 36 (4): 387-389.
 Ronald Coase (1974). "The Lighthouse in Economics". *Journal of Law and Economics* 17 (2): 357-376.
["http://en.wikipedia.org/wiki/Public_good"](http://en.wikipedia.org/wiki/Public_good)

Structure

4.1 Public Debt Management

4.2 Bibliography

4.3 Exercises

4.1 Public Debt Management

Deficit financing has come to be a widely accepted technique for financing the government expenditure in recent years in both economically advanced and the underdeveloped countries. In the economically advanced countries the technique has been resorted to on a large scale particularly since the Keynesian revolution of the thirties in order to maintain a steady rate of growth of income without inflationary or deflationary tendency in the economy. A major reliance was also placed on this method for financing the Second World War by the belligerent countries during the 'forties. In the low-saving underdeveloped ----- the principal *raison d'être* for deficit financing has been to forcibly boost the volume of savings and thus raise the rate of growth of income.

As necessary corollary of the large increase in the magnitude of deficit financing, there has been parallel increase in the volume and variety of public debt and the government has entered the private credit market as a big borrower. A large increase in the volume and variety of public debt has, in its turn, created some special and hitherto unforeseen problems in the nature of the management of such debt — problems which have often been of such a big order as to have greatly taxed the wit of the government officials entrusted with the task of management of the public debt.

A growing volume of public debt imposes a burden on the community to the extent it requires a larger and larger amount of transfer of resources by the state from the taxpayers to the holders of the government obligations and the ultimate limit to the size of the public debt is determined by the feasibility of such transfer. The realization of a larger amount of resources by way of taxes involves mereasing amount of strains and frictions; and the less

the amount of such strains and frictions, the greater is the possible size of the public debt. It follows from this that the most important prerequisite for an efficient management of the public debt is that the debt should be so issued, the pattern of maturity structure of the bonds should be so fixed, the interest rates should be so managed, taxes should be so devised and bonds should be so redeemed that the strains and frictions are kept at the minimum.

The most important requirement for an efficient management of public debt is that the interest rates on the government obligations should be kept at as low a level as possible and the pattern of interest rates on different maturities of the securities should be so worked out as would most neatly conform to the preference pattern of the individuals. The lower the average rate of interest on the government securities, the smaller will be the required amount of the recurring transfer of resources from the taxpayers to the bondholders and therefore, other things remaining the same, the less will be the strains and frictions associated with a given amount of public debt. As a matter of fact, this is the principal reason as to why the advanced capitalist countries, notably the USA and the UK, followed a low interest rate policy on government securities, though, admittedly, in the UK the motive behind it was also the "euthanasia of the renter", which was an accepted policy of the post-war Labour Government. Besides, individuals and institutions generally like to hold debts of different maturities from the shortest to the longest in order to strike an optimum balance in their portfolios between the conflicting interests of liquidity and solvency, on the one hand, and the highest possible interest income, on the other. The officials entrusted with the management of public debt will have to so fix the pattern (as contrasted to the level) of interest rates on the different maturities of government securities that the debt-holders are able to attain the highest possible indifference surface by the holding of a mix of different types of available public debt. In other words, a given amount of loan may be raised by the government through a number of mixes of government securities and through different patterns of interest rates on different maturities of securities and it is the responsibility of the managers of maturities of securities and it is the responsibility of the managers of public debt to work out that asset mix and that particular pattern of interest rates which would conform most to the preference pattern of holders who, as a result, might derive the greatest amount of satisfaction from the holding of the debt.

One technique widely utilized by the governments now-a-days in order

to make the structure of the public debt conform to the preference pattern of the individuals in called "swapping operation". The operation consists in the simultaneous purchase and sale by the central bank (or any other manager of public debt) of government securities of different maturities, leaving the total volume of the securities unchanged and hence without releasing in or absorbing from the economy any additional bank reserves, but altering the composition of the securities and hence the pattern of interest rates on such securities.

Empirically it is found that the strategy of the governments in all the countries, who have placed major reliance on deficit financing, has been to deem a very low rate of interest on the shortest-term government securities and to increase the rate gradually, and sometimes by discontinuous spurts, as the maturity period of the debt lengthens. This may give rise to such wide spreads between the short and the long-term rates of interest as to induce pattern-playing switching over from the shorter ends to the longer ends of the market by the holders of the public debt, with the accompanying problem of debt management and the impotency of the monetary policy. Even if such discontinuities or kinks in the interest rate structure on public debt are absent, it should, however, be noted that the shorter the duration of a public debt, the greater will be the ratio of matured debt to total debt at any point of time and the greater, consequently, will be the obligation of the government at any point of time to repay the amount to the lender. The repayment obligation, its turn, will involve the obligation to raise the fresh amount of resources by means of taxes and/or, in the event of the government's decision to maintain the previous volume of public debt, to float a fresh parcel of securities of equivalent amount out of the proceeds of which the due interest obligation may be met. But whatever be the decision taken, it is clear that the proportion of short-term debts to the total volume of public debt, the greater on average will be the incidence of the repayment obligation of the debt of government at any particular points of time with the accompanying problem to fresh tax and/or fresh floatation of debts by the government. This disadvantage of shorter-term debts should be weighed against the advantage of the comparatively small interest obligation on such debts. The longer-term debts, on the other hand, have a comparatively smaller repayment obligation—an advantage which should be counterbalanced by the higher interest obligations on such debts.

It follows from the above that any system of public debt under which the holders of the debt are free and/or induced to move rise their debt obligations

before their maturity period is bound to create more problems for the managers of public debt than any system under which such freedom and/or inducement is limited or absent. Apart from the adverse effects on an effective exercises of monetary policy which the monetization of public debt involves, a large volume of monetization of the debt obligations by the holders thereof may actually mean that the government's repayment obligation of the debt at any point on time may be virtually unlimited with the exist ion glare size of such debt obligations, with the consequential strains on the central banking systems of the country (which now-a-days is generally entrusted with the stack of floatation and redemption of public debt on behalf of the government). It is, therefore, a great virtue of the art of public debt management that such freedom of and/or inducement to monetization of public debt should be kept at a minimum and various devices have in fact been worked out to this end. One such device is to fix interest rates on intermediate-and long-term government obligations in such a way that the rate of interest per annum on each type of government securities rises progressively; with the increased in the period for which the security is held. Thus though the holder of security is often given option to monetize his debt holding before their maturity periods (in order overcome his resistance to purchasing the government securities particularly when attractive interest rates are offered in the private credit market), he is penalized in the shape of receipt of a very low interests income if he actually monetizes its "too early" and he is rewarded in the shape of a higher interest rate if the monetization is deferred to or near the maturity period of the securities. Another devices to float non-marketable securities; but in this case the advantage of non-monetization should be weighed against the disadvantage of the higher levels of interests rates, which such securities would inevitably bear. A third variant of device is to combine a system of non marketability of the securities for a particular period from the date of floatation of the securities with the features of progressive interest rates, the rate of interest increasing with the increase in the period for which security is held.

The issue of large amount to public debt is likely to create stringency in the private capital market, other things remaining the same. This will be so because, assuming that there is not much idle fund in the capital market, the debt which will be floated by the government will be held by individuals, banks and non-bank financial intermediaries which would have otherwise gone to the private capital or money market and this reduces availability of credit in the private credit market and is likely to raise the rate of interests. Such rise in

the rate of interest is, however, extremely detrimental to a sound debt management policy. For one thing, a rise in the rate of interest in the private credit market is bound to result in an upward pressure in the government credit market which increases the burden of the public debt. More importantly, it is an accepted notion of debt management policy that there should be an "orderly condition" in the government security market. This "orderly condition" is ensured only if the government can successfully assure the investors in government securities of the continuance of the level and pattern of interest rates stipulated on the government securities. The investors must be assured that after they have purchased the securities they would not have to suffer a capital loss.

Major plank of a sound debt management policy is a co-operating monetary policy. Now a days, with the wide power of the government over the central banking organization this co-operation has been quite easy to obtain. As a matter of fact, in the interest of the debt management policy, the central banking system is often made the residual purchasers of the government securities at par so that whenever, e.g., there is an excess supply in the volume of government securities following their holder's willingness to monetize them, the central bank stands ready to purchase them so that the excess supply is wiped out and there is no downward pressure on the security prices or upward pressure on the interest rates. Stated alternatively, with the extensive authority of the government-dominated central banking system to engage in open-market purchase and sale of government securities, the maintenance of stable price of the government securities and thus an orderly condition in the government security market has not been found to be difficult. Thus the floatation of public debt is generally accompanied by required degree of purchase, and redemption by sale, of government securities in the open market by the central bank so that the people's liquidity preference is just satisfied by the injection of money into, and withdrawal thereof from, the system at the prevailing rate of interest.

The above policy, while easing the task of management of public debt, has, it should, however, be noted, erected major obstacles to an effective implementation of the monetary policy. In other words, though the floatation of the public debt is deflationary (since it tends to raise the rate of interest) the existence of a large amount of public debt generally has grave inflationary potential so much so as to defy its effective control by a vigorous use of monetary policy. This is so because, apart from the destabilizing effect on government credit market which an increase in the rate of interest, following a

vigorous use of monetary policy entails, the presence of a large volume of government securities considerably eases the access of the spending units to money from government securities, because of the latter's characteristics of high liquidity and risklessness which make them close substitutes of money. In other words, government securities are, so to say, "money sitting" which can be very easily transformed into "money on the wing", and hence with the effective money supply thus augmentable, the economy may be subjected to serious occasional inflationary pressures. Account should also be taken of the fact that under a fractional reserve banking system topped by central banking organization, any increase in the holding of public debt by the central bank and the consequent increase in their liability correspondingly increases the cash assets of the commercial banks on the basis of which such banks make a multiple increases in their deposits potential. Further, it is often sought to be shown that the great increase in the amount of public debt and the fluctuations in their demand, supply and prices over the business cycles tend to amplify the magnitude of the cycles. Thus in their earlier phases of the boom the economic units expecting a rise in the commodity prices but no change in security prices, want to hold commodities only disposing of both squirts and money. While an excess supply of securities tends to lower their process and thus raise the rate of interest (since the rate of interest = $1/\text{security price}$), an excess supply of money tends to lower the rate of interest. In the initial phase of the upswing, the second effect is likely to predominate over the first effect and the interest rate is thereby reduced. In the next stage in the upswing when the economic units accept both the commodities and securities at the expenses of money. A rise in the demand for securities causes a further fall in the interest rates that adds further momentum to the upswing. For a fall in security prices in the following stage a rise in commodity prices is accompanied which induces the economic units to hold commodities and money by disposing the securities. This causes a fall in the prices of the securities or a rise in the rate of interest. As the rise becomes sufficient and as it is accompanied with an expectation of a fall in the commodity-prices, the downturn sets in. In the down-swing phase, there is, at first, a shift from the holding of commodities to both securities and money (but more to money) and, as a result, the interest security to money is anticipation al a fall in security process also which causes a rise in the interest rate aggravating the downturn. The expectation of a rise in the security prices revives gradually in the depth from both money and commodity to security which pushes down the interest rate and eventually facilitates the recovery.

The above sequences notation are used: C-Commodity; S- Security; M-Money; +, 0, and — signify expectation of rise, status quo and fall respectively in the prices, and so on); the indication "→" signifies "shift" by the economic units from the holding of one type of item to another type (e.g. "M → C" means the economic units will shift from money to commodity, and so on).

	C_+	C_0	C_-
S_+	(3) M → C M → S	C → S M → S	(7) C → S M → S
S_0	(2) S → C M → C	—	(5) C → S C → M
S_-	(4) S → C S → M M → C	— S → C S → M	(6) S → M C → M

The Table shows the pattern of shifts between the holdings of the commodities, securities and money by the economic under different sets of expectation of such units of the future course of the commodity and security prices over the course of the business cycles. Starting from the stationary position to the top of the boom and back again to the stationary position the economy passes through the stages from (1) to (2) to (3) to (4) to (1) in the Table. Starting from the stationary position to bottom of the depression and back the economy passes through the stages from (1) to (5) to (7) to (1).

It is clear from the above that the existence of a large volume of public debt adds to the severity and longevity of the booms and depressions.

4.2 □ Bibliography

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4.3 □ Exercises

1. What does the word 'Budget' originally meant?
2. What it means in public administration?
3. What is budget? How a government budget is made?
4. Write notes on concept, evolution & budget as a tool for administrative efficiency?
5. How *Medium-term budget frameworks* and *Macroeconomic frameworks* are made?
Output budgeting
6. What are the key characteristic of a medium-term framework are as follows :
7. What is known as the line-item budget?
8. What are the shortcomings in the conventional budget system?
9. What is known as the principle of performance budgeting?
10. Write essay on the preparation of budget and role of finance ministry?
11. The Role of Parliament in Financial Accountability and Management in India

● **Short questions:**

1. Write notes on
2. Deficit financing:
3. Fiscal deficit:
4. Revenue deficit
5. Budgetary deficit
6. Planning
7. Programming
8. The objectives of *budgeting*
9. Performance budgeting
10. Principles of performance budgeting in an organization.
11. What are the possible solutions to the free rider problem?
12. What is coasian solution?
13. What are smart decisions?

● **Clarify the following concepts:**

1. The PPBS framework
2. CB TREE STRUCTURE
3. Prog and activity structure
4. The free rider problem
5. Cost-benefit process
6. Cost-effectiveness disadvantages
7. Cost-effectiveness procedure
8. Cost-effectiveness advantages
9. Cost-effectiveness
10. Dominant assurance contracts
11. Essential requirements for simple cost-benefit process

● **Large Questions:**

1. Write an essay on zero-base budgeting and limitations of ZBB?
2. What is public good ? What are the differences between private and public goods ?
3. What are global public good and collective goods?

4. What are the types of goods?
5. *Write an essay on areas of public goods*
6. Write an essay on theories of public goods
7. Write an essay on public debt management
8. Write an essay on meaning and features, measurement of performance budgeting.
9. Write an essay on processes of performance budgeting.
10. Write an essay on Planning, programming and budgeting system (PPBS)

Structure**1.0 Introduction on Auditing and Accounting****1.1 Introducing Financial Audit****1.2 Purpose****1.3 Evolution****1.3.1 Audit of Government Expenditure****1.3.2 Audit of Companies and Regulation of Auditors****1.3.3 Evolution of Audit Since Independence****1.4 Types of Auditors****1.4.1 Internal Auditing****1.4.2 Role of Executive Departments****1.4.3 Audit Committes****1.4.4 Other Agencies****1.4.5 Local (Third Tier of) Government-Panchaytas and Municipalities****1.5 Stages of An Audit****1.6 Significant Global Audit Firms**

1.0 □ Introduction on Auditing and Accounting

An independent audit of financial statements is one of the foundations for the effective operation of the capital markets. Audit quality is vital for maintaining trust in the financial reporting process and the Integrity of financial information. Audit teams equipped with a high level of technical skills and empowered with professional skepticism provide the heart and soul of a good audit. Further audit must be done by following some basic principles:

- Audit methodologies must focus on fundamentals and guide good audit judgments.
- Audit methodologies must allow for critical data comparisons, and

enhance contextual analysis. Technology can provide for effective information gathering, Compliance tools help the auditor meet professional and regulatory requirements.

- Audit must begin with a broad understanding of an organization to focus on key areas of risk, adequacy of internal controls, and potential fraud.
- Audit must take into account culture, values and code of conduct of the organization concerned, which are fundamental to how business is done. The Organizational culture has a significant impact on audit quality. Cultural values have their role in the capital markets. Simultaneously cultural values should encourage fair judgment and objectivity in auditing.

The most general definition of an audit is an evaluation of a person, organization, system, process, project product. Audits are performed to ascertain the validity and reliability of information, and also provide an assessment of a systems internal control. Auditing is therefore a part of some quality control certifications such as ISO 9000. An audit is based on random sampling and is not an assurance that audit statements are free from error. However, the goal is to minimize any error, hence making information valid and reliable.

Traditionally audits were mainly associated with gaining information about financial systems and the financial records of a company or a business. However recently auditing has begun to include other information about the system, such as information about environmental or academic performance. As a result there are now professions that conduct environmental or academic audits. Universities in recent years go for academic audits for themselves and for their affiliated colleges or institutions (if any).

Value for Money or 3E's Audit, so known as Performance audit is an independent assessment of the performance of an organization, programme, project or an activity in terms of its goals and objectives-how far expected results have been achieved from the use of available resources of money, men and material. An examination is made regarding economy, efficiency and effectiveness of public spending, known as 3E's audit.

- Economy minimizing the cost of resources used or required - spending less,
- Efficiency the relationship between the output of goods and services and the resources to produce them- spending well.

- Effectiveness: the relationship between the intended and actual results of public spending - spending wisely.

The concept and technique of audit has undergone a major change during the last fifty years. Before India became independent, the government audit was mostly confined to check against provision of funds, rules and orders and competence of authority concerned to sanction expenditure. With the launching of the Five Year plans for economic and social development there has been change in the pattern of government expenditure necessitating shift in the emphasis, concept and practice of audit as scrutiny of individual transactions became inadequate as it tended to mistake wood for the tree. The Parliament and the public are more interested to know whether various development and welfare programmes are being executed efficiently and whether they were producing the expected results. This lead Audit department to enter in the area of Performance Evaluation and Value for Money Audit. Audit department is now producing a iurg'. number of performance reviews every year covering almost every facet of government's working.

In financial accounting., an audit is an independent assessment of the fairness by which a organization 's financial statements are presented by its governing personnel or ministries cor by management, it is performed by competent, independent and objective person or persons, known as auditors or accountants, who then issue a report on the results of the audit.

Such systems must adhere to generally accepted standards set by rule making bodies that regulate the conduct of the organization, it simply provides assurance for third parties or external users that such statements present 'fairly' a organization's financial condition and results of operations.

The traditional audit conducted by the supreme audit institutions (SAI) is known as Regularity audit which implies checking upon the legality of an action taken by a public official or a person using public funds and whether the decision or its implementation is according to the law, rules or regulations governing that activity Gradually its dimension was extended to Financial audit and now to Value for money audit. Financial Audit basically means audit of financial statement and whether they provide reasonable assurance that they present fairly the financial position, results of operations, and cash flows of an audited entity in accordance with generally accepted accounting principles. In Financial audit, State auditors do almost the same kind of job which the Chartered Accountants do while auditing a public limited company.

1.1 □ Introducing Financial Audit

An important type of audit is the financial audit. It is designed to determine whether financial statements are fairly presented in accordance with International Financial Reporting Standards (IFRS) or Generally Accepted Accounting Principles (GAAP). A financial audit, or more accurately, an audit of financial statements, is the examination by an independent third party of the financial statements of a company or any other legal entity (including governments and individuals), resulting in the publication of an independent opinion on whether or not those financial statements are relevant, accurate, complete, and fairly presented. The financial audit is one of many assurance or attestation functions provided by accounting and auditing firms, whereby the firm provides an independent opinion on published information.

In USA, financial audits are required for all publicly registered companies. In India, financial audits are required for all such institutions who directly or indirectly receive money from the government or are somehow regulated by the rules of the government.

Government financial reports are not always audited by outside auditors. Some governments have elected or appointed auditors.

Financial audits are typically performed by firms of *practising accountants* due to the specialist financial reporting knowledge they require. Many organisations separately employ or hire internal auditors who do not attest to financial reports but focus mainly on the internal controls of the organisation. External auditors may choose to place limited reliance on the work of internal auditors.

1.2 □ Purpose

Financial audits exist to add credibility to the implied assertion by an organisation's management that its financial statements fairly represent the organisation's position and performance to the firm's stakeholders (interested parties). The principal stakeholders of a company are typically its shareholders, but other parties such as tax authorities, banks, regulators, suppliers, customers and employees may also have an interest in ensuring that the financial statements are accurate.

The audit is designed to reduce the possibility of a *material misstatement*. A *misstatement* is defined as false or missing information, whether caused by fraud (including deliberate misstatement) or error. *Material* is very broadly

defined as being large enough or important enough to cause stakeholders to alter their decisions.

Financial audits may be performed for private companies, registered charities, and some governmental and public entities. Private companies typically request financial audits year after year because lenders may have required an audit or owners may want to have external unbiased eyes look at the financial statements to determine if the company is complying with all the required accounting principles. Charities would require a financial audit to show the financial status of the organization to potential donors. Governments and government businesses are usually required to be audited by statutes to determine whether the money budgeted has been properly spent.

Other than testing the reliability of a firm's expenditure details, financial audits can alert management to areas of high risk. Strategic systems auditors are now providing a top down approach to audit by first examining a organization's business strategy and keys to competitive advantage.

The exact 'audit opinion' will vary between countries, firms and audited organisations.

In the US, the CPA firm provides written assurance that financial reports are 'fairly presented in conformity with generally accepted accounting principles (GAAP).' The measure for 'fairly presented' is that there is less than 5% chance (5% audit risk) that the financial statements are 'materially misstated.'

In England and Wales, the Registered Auditors including Chartered Certified Accountant (ACCA) and Chartered Accountant (CA or ACA) provide 'reasonable assurance' that the financial statements are 'free from material misstatement', and that they give 'a true and fair view' of the state of the company's affairs as at a particular date, and of its profit/loss for the period then ended, and have been 'properly prepared in accordance with the Companies Act 1985' or other relevant legislation.

1.3 □ Evolution

1.3.1 Audit Of Government Expenditure

The earliest instance of auditing government expenditure is a reference to the Auditor of the Exchequer in England in 1314. The Auditors of the Imprest were established under Queen Elizabeth I in 1559 with formal

responsibility for auditing Exchequer payments. This system gradually lapsed and in 1780, Commissioners for Auditing the Public Accounts were appointed by statute. From 1834, the commissioners worked in tandem with the Comptroller of the Exchequer, charged with controlling the issue of funds to the government.

Public audit is a vital instrument of ensuring supremacy of Parliament over executive and enforcing public accountability. Public audit institutions developed over time to help legislatures to implement the power of the purse. This power had two essential elements: the granting of the moneys and supervision of the expenditure. State audit in its present form was introduced first time in Great Britain as an integral part of parliamentary control over national finance with the enactment of Exchequer and Audit Department Act in 1866. the Act required all departments for the first time, to produce annual accounts known as appropriation accounts. The act also established the position of Comptroller and Auditor General (C&AG) and an Exchequer and Audit department to provide the supportive staff from within the civil service. An expert parliamentary committee called the Committee on Public Accounts thus establishing a circle of parliamentary financial control considered the results of C & AG's investigations.

As Chancellor of the Exchequer, William Ewart Gladstone initiated major reforms of public finance and Parliamentary accountability. His 1866 Exchequer and Audit Departments Act required all departments, for the first time, to produce annual accounts, known as appropriation accounts. The Act also established the position of Comptroller and Auditor General (C&AG) and an Exchequer and Audit Department (E&AD) to provide supporting staff from within the civil service. The C&AG was given two main functions - to authorise the issue of public money to government from the Bank of England, having satisfied himself that this was within the limits Parliament had voted - and to audit the accounts of all Government departments and report to Parliament accordingly.

The National Audit Office and Audit Commission now carry out auditing of UK government expenditure.

The system of Government accounting and auditing and the organisational structure of the Indian Audit and Accounts department (IAAD) as it exists today in our country is the legacy of British Raj and is more or less patterned on British model. The "IAAD has a history dating back to 1858 when the East India Company administration was taken over by the British

Government and an Auditor General of India, who looked after both audit and accounts functions, was appointed. The introduction of constitutional reforms in 1919 brought about statutory recognition to the Auditor General. The Government of India Act 1935, gave further recognition to the importance and status of the Auditor General.

The Indian Constitution gave special status to Comptroller & Auditor General (C&AG) as laid down in Articles 148 to 152. The C & AG's Act, 1971 regulate the duties, powers and conditions of service of the Comptroller and Auditor General. Section 13, 16 and 17 of Act gives authority to C & AG to audit all expenditure from and receipt into the consolidated fund of India and the State. Section 14, 15, and 20 of the Act authorizes C&AG to audit the receipts and expenditure of bodies or authorities substantially financed by loans or grants from Union or State or Union Territory. Article 151 of the Constitution prescribes that Audit Reports on the accounts of Union and the States be submitted to Parliament /State Legislature.

1.3.2 Audit Of Companies And Regulation Of Auditors

In the US, prior to the 1930s, corporations were required neither to submit annual reports to government agencies or shareholders nor to have such reports audited. In the United States, the Securities Exchange Act of 1934 required all publicly traded companies to disclose certain financial information, and that financial information be audited. The establishment of the Securities and Exchange Commission (SEC) created a body to enforce the audit requirements.

In the United States, the SEC has generally deferred to the accounting industry (acting through various organizations throughout the years) as to the accounting standards for financial reporting, and the U.S. Congress has deferred to the SEC.

This is also typically the case in other developed economies. In the UK, the institutes (including ACCA, ICAEW, ICAS and ICAI) set auditing guidelines. Auditing firms and individual auditors are members of these institutes. Accordingly, financial auditing standards and methods have tended to change significantly only after auditing failures. The most recent and familiar case is that of Enron. The company succeeded in hiding some important facts, such as off-book liabilities, from banks and shareholders. Eventually, Enron filed for bankruptcy, and (as of 2006) is in the process of being dissolved. One result of this scandal was that Arthur Andersen, then

one of the five largest accountancy firms worldwide, but their ability to audit public companies, essentially killing off the firm.

A recent trend in audits (spurred on by such accounting scandals as Enron and WorldCom) has been an increased focus on internal control procedures, which aim to ensure the completeness, accuracy and validity of items in the accounts, and restricted access to financial systems. This emphasis on the internal control environment is now a mandatory part of the audit of SEC-listed companies, under the auditing standards of the Public Company.

1.3.3 Evolution of Audit since Independence

Audit of Revenue: C&AG after some initial resistance on the part of revenue department was able to extend its dimension to audit of revenues which includes audit of tax assessment such as Income tax, Central Excise and Customs, Sales tax etc. The audit of receipts has helped bringing considerable revenue for the government by pointing out cases of under assessment of tax, and also assisted in better functioning of tax administration machinery by pointing out lacunae or loopholes in the Act/ Rules and deficiencies in the functioning of tax administration.

Audit of Commercial Enterprises: The audit of government companies was brought within the purview of C&AG's audit at the insistence of then CAG by introducing a suitable provision in the Companies Act 1956, although there were initial attempts to exclude his jurisdiction. Thus, while Chartered Accountants are required to certify Annual Accounts of government companies, C&AG has been granted right to conduct supplementary audit.

1.4 □ Types of Auditors

There are Two Types of Auditors:

- **(A) Internal auditors** are employees of a company hired to assess and evaluate its system of internal control. To maintain independence, they present their reports directly to the Board of Directors or to Top Management / government authority. They provide functional operation to the concern. Internal Auditors are employees of the company / government so that they can easily find out the frauds and any misappropriation.
- **(B) External auditor** are independent staff assigned by an auditing firm to assess and evaluate financial statements of their clients or to

perform other agreed upon evaluations. Most external auditors are employed by accounting firms for annual engagements. They are called upon the out side of the company.

The relevant administrative ministry has the main responsibility for ensuring that (i) expenditure is incurred for the approved purpose, (ii) it is within the sums allotted, (iii) it has been incurred under the authority competent to sanction it, and (iv) due prudence has been shown in its incurrence. As ministries have delegated their powers to lower functionaries, the basic responsibility is shifted to the particular functionary concerned, but overall responsibility remains with the administrative ministry.

As per rules, no public authority can incur any expenditure or enter into any liability involving expenditure or transfer of moneys for investment or deposit from government account unless such expenditure or transfer, as the case may be has been sanctioned by general or special orders of the Government or by any authority to which power has been delegated in this regard. No expenditure can be incurred against a sanction unless funds are made available to meet the expenditure by valid appropriation or re-appropriation. The government authorities have to comply with rules prescribed in the General Financial Rules and the Delegation of Financial Power Rules in all financial matters. The designated controlling authorities have to ensure not only that the total expenditure is kept within the limits of the authorised grants but also that the funds allotted to spending units are expended in the public interest and on objects for which the money was provided.

In order to maintain proper control, the controlling officer obtains information on not only what has actually been spent from the grants but also what commitments and liabilities have been and will be incurred against them. He must be in a position to assume, before the Government and Public Accounts Committee, complete responsibility for departmental expenditure and to explain or to justify any instance of excess expenditure or financial irregularity that may be brought to notice as a result of audit scrutiny or otherwise. In the discharge of his ultimate responsibility for the administration of a grant, or a part thereof, placed at his disposal, every controlling officer must satisfy himself not only that adequate provisions exist within the departmental organisation for systematic internal checks calculated to prevent and detect errors and irregularities in the financial proceedings of his subordinate officers and to guard against waste and loss

of public money and stores, but also that the prescribed checks are effectively applied.

As regards receipts, it is the duty of the departments concerned to ensure that the dues of Government are correctly and promptly assessed and paid into the treasury/bank. All moneys received by or on behalf of Government either as dues of Government or for deposit, remittance or otherwise are required to be brought into Government Account without delay in accordance with the prescribed rules and regulations.

In view of the volume of expenditure particularly in regard to large projects and programmes, the system of 'Financial Advisers' has been established at the Union level. Prior to 1976 there were two separate functionaries, namely, Internal Financial Adviser and Associated Financial Adviser. A system of Integrated Financial Advisers is now operative. This system ensures the availability of in-house expert advice to administrative ministries and departments.

In regard to the financial powers which have been delegated to the ministries, the Financial Adviser acts as a part of the administrative ministry and his advice can be overruled by the ministry concerned. However, in those areas where the financial powers have not been delegated, this functionary acts on behalf of Ministry of Finance. In such areas he can be overruled only with the approval of the Ministry of Finance.

1.4.1 Internal Auditing

In India major importance is attached to the system of internal audit in Government. It is recognised that the continuing examination of the accounting and financial records, of systems and procedures, and of compliance with stated management policies, are essential elements of internal audit and a positive help to public administration. Accordingly each ministry and department of the Union Government has a special unit under the direct control and supervision of Financial Advisers.

All ministries and departments prepare their own internal audit manuals which detail the duties and functions of the internal audit unit. The findings of this unit are submitted to the permanent secretaries of the ministries concerned.

The audit by the CAG also lays a great deal of stress on the adequacy of internal audit systems. In those instances where the CAG is of the opinion

that these systems need to be strengthened, appropriate comments and recommendations are made in his reports.

1.4.2 Role of Executive Departments

Responsibility for monitoring the progress of expenditure against a Grant devolves on the executive which is ultimately responsible for keeping the expenditure within that Grant. In order to make control of expenditure against appropriations an operative reality, an efficient monitoring system has been established. A monthly return indicating separate plan and non-plan expenditure figures is prescribed to be furnished by the spending authorities. The consolidated information shows the sanctioned grant and the progressive total of expenditure incurred from month to month for a ministry as a whole. The system also provides for reconciliation of the departmental figures with the accounts figures. The ministries also obtain the details of physical progress of developmental schemes. These details include the budget provision, the progressive expenditure and the physical progress of each scheme in addition to the reasons for any financial and physical variations. The data relating to the progress of expenditure and the physical progress of the schemes are analysed every month and remedial action as considered necessary initiated.

The Accounts Officers under the Financial Adviser of each Ministry also keep a watch over the progress of expenditure and report to the departmental head concerned immediately if there is the likelihood of any grant being exceeded. Such financial surveillance provides an additional control mechanism to enable timely action by the executive.

1.4.3 Audit Committees

In order to ensure speedy action on audit findings, instructions are issued by the Ministry of Finance either on its own initiative, or on the basis of suggestions by the CAG or on the recommendations of the Public Accounts Committee. These instructions require the (i) specification of time limits, (ii) designation of responsible officials and (iii) appointment of audit committees.

1.4.4 Other Agencies

For effective control and monitoring of implementation of the developmental programmes and schemes, the Government of India has

recently set up a separate Ministry of Programme Implementation. This ministry closely monitors the implementation of major public sector projects and programmes. It also assists various other ministries in the preparation of Annual Action Plans and in the review of associated performance reports. For monitoring and generation of periodical reports, the system has been computerised by developing requisite data bases.

The National Informatics Centre, set up as a nodal agency, has developed several data bases and continuously monitor all plan and non-plan programmes through a computer network known as NICNET which provides the data required by various users. The main users of such data presently are the Prime Minister's Office, Planning Commission and Ministry of Programme Implementation. The computer network is being extended to cover district treasuries in the States as well.

1.4.5 Local (Third Tier of) Government- Panchayats and Municipalities

Consistent with the philosophy of devolution of powers and strengthening of local self government institutions, the constitution, composition, power and duties of Panchayats and Municipalities were enshrined in the Constitution by making 73rd amendment in 1993. Bulk of finance for panchayats municipalities comes from government but there is no satisfactory arrangement for their audit. Article 243 - 243 Z states, "The Legislature of a state may, by law, make provisions with respect to the --- of accounts by the Panchayats/ Municipalities and the auditing of such accounts." Hardly any State has made law in this regard. The old arrangement continues and the Examiner Local Fund Accounts, which functions under the Finance department, audits the accounts of these bodies. With the policy of progressive empowerment of the self-governing institutions receiving greater emphasis with attendant prospect of sizable percentage of state funds being handled by these institutions appropriate public audit mechanism need to be considered,

It may be noted that keeping in view the importance of Local bodies in England an Audit Commission has been constituted in 1982 for auditing Local Authorities and National Health Service. Similarly in France, Regional Courts of Accounts have been created in 1982 as part of wider policy of decentralisation which is empowered to audit all local authorities.

There is need for placing accounting and audit arrangement of

Panchayats and Municipalities on sound footing and it is for consideration whether a Central legislation be enacted, with Comptroller and Auditor General having authority to lay down accounting and auditing standards and general superintendence over such audit.

Government has set up District Rural Development Agency (DRDA), as a registered society headed by an elected representative, in every district of the country to which Central/ State government grants are given directly. DRDA's pass on money to Zila Parishad's for various poverty alleviation programmes. No satisfactory system of audit of DRDA/ ZP has been developed although money spent by them comes from the Consolidated Fund of India /State and a staggering' some of about Rs 10000 crs is spent annually. Chartered accountants certify their Annual Accounts on the basis of perfunctory information available to them regarding usage of money and they do not automatically fall within the audit jurisdiction of C&AG.

1.5 □ Stages of An Audit

A financial audit is performed before the release of the financial statements (typically on an annual basis), and will overlap the 'year-end' (the date which the financial statements relate to).

The following are the stages of a typical audit:

Planning and risk assessment

Timing: before year-end

Purpose:

- To understand the business of the company and the environment in which it operates.
- To determine the major audit risks (i.e. the chance that the auditor will issue the wrong opinion).

For example, if sales representatives stand to gain bonuses based on their sales, and they account for the sales they generate, they have both the incentive and the ability to overstate their sales figures, thus leading to overstated revenue. In response, the auditor would typically plan to increase the rigour of their procedures for checking the sales figures.

Internal control testing

Timing: before and/or after year-end

Purpose:

To assess the internal control procedures (e.g. by checking computer security, account reconciliations, segregation of duties). If internal controls are assessed as strong, this will reduce (but eliminate) the amount of 'substantive' work the auditor needs to do.

In some cases, an auditor may not perform any internal controls testing, because he/she does not expect internal controls to be reliable. When no internal control testing is performed, the audit is said to follow a substantive approach.

Substantive procedures

Timing: after year-end

Purpose:

- To collect audit evidence that the actual figures and disclosures made in the Financial Statements are reliable and in accordance with required standards and legislation.

Methods:

- Where internal controls are strong, auditors typically rely more on **Substantive Analytical Procedures** (the comparison of sets of financial information, and financial with non-financial information, to see if the numbers 'make sense' and that unexpected movements can be explained)
- where internal controls are weak, auditors typically rely more on **Substantive Tests of Detail** (selecting a sample of items from the major account balances, and finding hard evidence (e.g. invoices, bank statements) for those items).

Some audits involve a 'hard close' or 'fast -close'¹ whereby certain substantive procedures can be performed before year-end. For example, if the year-end is 31st December, the hard close may provide the auditors with figures as at 30th November. The auditors would audit income/expense movements between 1st January and 30th November, so that after year end, it is only necessary for them to audit the December income/expense movements and the 31st December balance sheet. In some countries and accountancy firms, these are known as 'roll forward' procedures.

Finalisation

Timing: at the end of the audit

Purpose:

- to compile a report to management regarding any important matters that came to the auditor's attention during performance of the audit,
- to evaluate and review the audit evidence obtained, ensuring sufficient appropriate evidence was obtained for every material assertion and
- To consider the type of audit opinion that should be reported based on the audit evidence obtained.

1.6 □ Significant Global Audit Firms

These firms are the 'Big 4' multinational accountancy firms which audit the majority of large quoted/listed world companies, They also provide other services including tax advice and strategic consultancy.

Firm	2005 global revenue (US dollars)
PricewaterhouseCoopers (corporate website)	20.3bn
Deloitte (corporate website)	18.2bn
Ernst & Young (corporate website)	16.9bn
KPMG (corporate website)	15.7bn

One of the major issues faced by private auditing firms is the need to provide independent auditing services while maintaining a business relationship with the audited company. The auditing firm's responsibility to check and confirm the reliability of financial statements may be limited by pressure from the audited company, who pays the auditing firm for the service. The auditing firm's need to maintain a viable business through auditing revenue may be weighed against its duty to examine and verify the accuracy, relevancy, and completeness of the company's financial statements. (http://en.wikipedia.org/wiki/Financial_audit)

Module III • Unit 2 □ Comptroller And Auditor General of India

Structure

- 2.1 Introduction**
 - 2.2 Appointment of Comptroller and Auditor General**
 - 2.3 Accountability of Public Sector Undertakings (Psu's)**
 - 2.4 Monitoring Mechanisms**
 - 2.4.1 The role of the supreme audit Institution (Sai)**
 - 2.4.2 Relationship With Parliamentary Committees**
 - 2.4.3 Auditing Standards**
 - 2.5 Weakness of the existing system in the context of its function**
 - 2.5.1 Position in Advanced Countries**
 - 2.5.2 Quality of Audit-Problems Due to C & AG's Highly Centralized Set-Up**
 - 2.5.3 C & AG and Parliament Interface**
 - 2.5.4 Accountability of C & AG—External Audit**
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2.1 □ Introduction

Article 148(1): There shall be a Comptroller and Auditor General of India who shall be appointed by the President by warrant under his hand and seal and shall only be removed from office in like manner and on the like grounds as a Judge of the Supreme Court.

2.2 □ Appointment of Comptroller and Auditor General

The office of C&AG embodies an institution of great importance. However, an institution, however exalted, is only as good as the incumbent holding it. Do qualified individuals get appointed to the post? The Constitution grants C&AG independence and an exalted status (Article 148) - he is appointed by President by a warrant under his hand and seal, has the same status as a Supreme Court judge, cannot be removed from office, his conditions of service cannot be varied to his disadvantage, his salary is charged on the Consolidated fund of India etc. During last three decades the appointment of C&AG has always been mired with controversy. From the

time the Constitution came into being in 1950, the four C&AG's appointed to the post, were senior members of the Indian Audit & Accounts Service. However from 1978 onwards the last four incumbents, are from the Indian Administrative Service(IAS). The appointment of C&AG who do not possess the requisite background of auditing and accounting has been subject of severe criticism by Chairman of the Public Accounts Committee, press, public spirited men, Officers and Staff association of the Audit department.

The Indian Constitution does not lay down qualification for the post of C&AG nor the manner of his selection. However the matter was discussed during the Constituent Assembly debates held in May 1949. From the debates it seems that framers of the Constitution's intention was that a person who had sufficient knowledge of finance and accounting systems and had practical experience of the work of Finance department and had worked as Accountant General would only be appointed. However, in practice this assurance has not been honored by successive governments.

The period for which CAG is presently appointed is 6 years with 65 as age of retirement. The President, Vice- President, members of Public Service Commission are all appointed for a 5 year term. There is a strong case to prescribe 5 year term with age of retirement at 65.

The Judiciary has the power even to declare a law invalid when the Legislature has exceeded its powers. Similarly the office of the Comptroller and Auditor General has the power to call to account any officer, however highly placed, so far as State moneys are concerned.

2.3 □ Accountability of Public Sector Under-takings (PSU's)

Where autonomous bodies are created under a specific act, the statute setting them provides for the audit arrangement. There are a number of corporations, particularly in financial sector such as nationalised banks, IDBI, IFCL, LIC which have been kept outside the ambit of C&AG's audit. This is possibly on the ground that government audit is not suitable and hamstrung their commercial operations. Audit of public enterprises by C&AG has always remained a controversial issue. In the 50's when PSU's were being set-up first time, there were attempts to bar C&AG's jurisdiction but the then C&AG resisted and the matter was resolved by amending the Companies Act and providing for supplementary audit of government companies by C&AG. Subsequently in the 70's, as a result of recommendation

of Administrative Reforms Commission, an Audit Board system was introduced to provide commercial type audit for PSU's. In the wake of current privatisation programme, government is making policy pronouncements that government portion of equity will be brought down to a level of 49 or 26 percent. This is ostensibly being done to free them from government control including audit as they would no longer fall within the definition of government company. Will this not tantamount to evasion of public accountability as by retaining sizable share-holding government could still exercise policy control over these companies but will not be answerable to Parliament?

There is an opposite view that government control and agencies such as CBI, CVC, and CAG hampers decision making and risk taking necessary for a commercial organisation and largely responsible for their poor performance. Public enterprise managers and experts argue that in an era of globalisation and liberalisation where competition is the new mantra government companies have to be provided the same level field as their compeers in private sector if they have to survive the market forces. They should therefore be given autonomy and supplementary audit by CAG be done away with.

In U.K nationalised industries were kept outside C&AG's audit from the beginning. However, British practice was more of an exception. France and Italy which have large public enterprises including banks fall within the jurisdiction of state audit. In USA under the Corporation Control Act, financial transactions of wholly owned corporations are audited by General Accounting Office.

Of late there has been tremendous change in the pattern of public expenditure due to the policy of devolution of administrative functions and parceling out certain activities to non-government organisations. A substantial part of public funds are transferred through complex financing arrangements to these autonomous bodies and NGO's which have mushroomed in thousands. How to verify that they have properly utilised the money and fulfilled the objective is a major challenge, as CAG has no access to their book of accounts. Presently Chartered Accountants certify their accounts which forms the basis of utilisation certificates furnished by them.

Article 151: Audit Reports-

- (1) 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.
- (2) 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.

The C&AG is the head of the Indian Audit and Accounts Department, The office of the C&AG directs, controls and monitors the activities of the various offices of the department and is responsible for development of organisational objectives and policies, auditing standards and systems, laying down policies for management of man power and final approval of the Audit report. For carrying on these responsibilities field formations exist for each specific areas of auditing and accounting.

The offices of IAAD are spread throughout the country. There are 34 Union Government Audit Offices headed by Director General) Principal Director of Audit and 60 State Accounts and Audit offices headed by Principal Accountant General and Accountant General. There are 60000 personnel in the IAAD with about 500 Group A officers belonging to the Indian Audit and Accounts Service (IA&AS). The total budget of the IAAD is around Rs 846 crs bulk of which constitutes expenditure on pay and allowances of the staff.

Position in Other Countries: India has been following British traditions of parliamentary democracy and the post of C&AG has been patterned on British model.

In U.K an act to strengthen Parliamentary control and supervision of expenditure of public money by making new provision for appointment and status of C&AG and establishing a National Audit Commission was enacted in 1983. The relevant provision regarding appointment of C&AG requires that the Prime Minister and Chairman of the Committee on Public Accounts should jointly select the incumbent and get it ratified by the House of Commons. In Australia Comptroller and Auditor General is appointed by the Governor General on the recommendation of the Minister, after the Minister has referred his recommendation to the Joint Committee of Public Accounts and Audit and the Committee has approved the same.

UK - National Audit Act 1983

- 1.-(1) The power of her Majesty under section 6 of the appointment

Exchequer and Audit Departments Act 1866 (appointment of Comptroller and Auditor General) shall be exercisable on an address presented by the House of Commons, and no motion shall be made for such an address except by the Prime Minister acting with the agreement of the chairman of the Committee of Public Accounts.

(2) The Comptroller and Auditor General shall by virtue of his office be an officer of the House of Commons.

In **USA** under the Budget and Accounting Act of 1921, the Comptroller General of the United States and the Assistant Comptroller General of the United States shall be appointed by the President with the advice and consent of the Senate. The Congress participates in the selection of the Comptroller General by providing a list of candidates from which the President may choose and by confirming the appointment. The GAO Act of 1980 further amplifies the selection process of Controller General, and stipulates establishing a Commission to recommend the name for the post.

In **Germany** the Bundestag and Bundesrat (Parliament) shall elect the president and Vice President of Bundesrechnungshof without debate.

In **Japan** the Commissioners of the Board of Audit are appointed by the Cabinet, with the consent of both Houses of the Diet.

In **Korea** the Chairman of the Board of audit is appointed by the President with the consent of the National Assembly.

Similarly in **Thailand** the appointment of Auditor General must receive prior approval of national Assembly.

In **India** it is necessary that the appointment of C&AG is kept outside the exclusive purview of the Executive. Recommendations regarding his appointment should be made by an independent committee. One could suggest that the committee should consist of the Prime Minister, Finance Minister, the Leader of the Opposition of the Lok Sabha and Chairman of the Public Accounts Committee. There is also need to prescribe qualification for appointment to the post and a person who has substantive experience of public sector accounting and auditing systems should only be appointed.

2.4 □ Monitoring Mechanisms

With the advent of the planned era in India following national independence, there was a major growth of economic development and social welfare activities. This growth necessitated an attendant increase in both

revenue and capital expenditure, and in receipts and borrowings to match such expenditure. These new responsibilities of the government and the complex nature of its expanded activities called for a change in the nature and scope of audit. Consequently audit by the SAI has evolved from an accountancy and regularity check to evaluation of the end results of the operations of government, including considerations of economy, efficiency and effectiveness.

The audit by the SAI is conducted under a Planned Programme covering the accounts, systems, procedures, projects and programmes on the basis of the documents and information submitted to the Indian Audit and Accounts Department. Field audits of the various organisations involved are an essential part of the overall programme. The initial audit findings are taken up with the appropriate authorities for remedial action through audit notes and inspection reports. Important audit findings, performance reviews of projects and programmes, and comprehensive appraisals of public enterprises and other bodies and authorities are processed for inclusion in the reports of the CAG which are laid before the Parliament or the State Legislatures as the case may be. Apart from the certification of the Appropriation Accounts and Finance Accounts of the Union and of 25 States and submission of separate audit reports on about 260 statutory corporations and other autonomous bodies for which the CAG is the sole auditor, the CAG brings out a large number of reports every year. These reports are of the following categories:

Union	States
Civil	Civil
Defence	Receipts
Railways	Commercial
Posts and Telecommunications	Autonomous Bodies
Direct Taxes	
Indirect Taxes	
Scientific Departments	
Autonomous Bodies	
Commercial	

The reports of the CAG after presentation to the legislature concerned are remitted to the related committees of Parliament and State Legislatures

for consideration and appropriate recommendations to the executive for remedial action which is further followed up by the committees.

2.4.1 The Role Of The Supreme Audit Institution (SAI)

The Comptroller and Auditor General of India (CAG) plays a crucial role in parliamentary financial control. The Indian Constitution provides for a unitary and independent audit by the CAG. The audited Appropriation and Finance Accounts are submitted along with the audit reports of the CAG to the president of India or the Governors of the States according to whether they relate to the Union or the States. These accounts and reports are then caused to be laid before the Union Parliament or the State legislatures concerned.

The primary function of the audit of the CAG is to verify the accounts to ascertain (1) whether the moneys shown in the accounts as having been disbursed were legally available for and applicable to the service or purpose to which they have been applied or charged and whether the expenditure conforms to the authority which governs it and (2) whether the assessment, collection and allocation of revenue have been properly done. The Appropriation and Finance Accounts are accordingly examined under the directions of the CAG and certified as to their correctness subject to his observations in his Reports on the Accounts submitted under Article 151 of the Constitution.

The jurisdiction of the CAG extends to the audit of Government commercial enterprises, as well as to bodies and authorities substantially financed from Government revenues. The CAG also examines the accounts relating to grants and loans given by the Government to other bodies. There is also an enabling provision in the act passed by the Union Parliament in 1971 to take up the audit of any other bodies or authorities with the approval of, or at the request of, the President or the Governors as the case may be.

The CAG has the authority to make regulations on the scope of audit. Such regulations are not subject to the approval of either the Government of the day or the Parliament. Thus, the CAG has complete discretion to regulate the scope of his audit. Apart from the traditional forms of audit, commonly known as the appropriation audit and regularity audit, the discretionary forms of audit (the propriety audit and the efficiency-cum-performance audit) developed by the CAG have assumed significance from the viewpoint of 'accountability' in a comprehensive sense. The audit looks beyond the mere

enditure to its prudence and economy and to a general
the efficiency and effectiveness with which an organisation is
its financial responsibilities.
owers of the CAG to have access to documents and information
tion with audit of accounts have been enhanced under the Act of
earlier, in certain cases he was obliged to accept a simple statement of
derived from a book or document which the highest executive authority
ed as secret. Now, no such restriction exists and the CAG can call for
document as long as it is considered relevant to the transactions to
his auditing duties extend. Further, the Act specifically enjoins that
ministration shall afford all facilities for his inspection and comply
is request for information in as complete a form as possible and with
reasonable expedition;

Relationship With Parliamentary Committees

e audit reports of the CAG, other than those relating to commercial
ises, are considered by the Public Accounts Committees. The
tees on Public Undertakings consider the audit reports relating to
cial enterprises. The various committees examine the many audit
on a selective, basis, assisted by the CAG or his Principal Audit
as follows:

istance in the selection of subjects.

ply of background information and memorandum of important
nts.

efing of the working groups/sub-committees for a proper
ertstanding of the subject.

efing of the chairmen of the committees, as and when necessary.

ndance at the sittings of the committees to assist in their examination
itnesses.

stigating of written submissions of the witnesses for ensuring factual
racy.

al verification of the reports of the committees.

tance at the sittings of the committees devoted to deliberation on
doption of their reports.

g through of the notes of government on action taken on the
mittees' recommendations.

- factual verification of the follow-up reports of the committees.
- Attendance to assist the committees at the sittings for consideration and adoption of their follow-up reports.

Informal assistance is also given to the individual members and the secretariat of the committees so as to enable them to have a proper understanding of the issues dealt with in the relevant audit report. In India the audit reports as such are not generally discussed in the Parliament or State Legislatures. However the recommendations of the committees are by convention considered as the recommendations of the entire Parliament. Hence, the assistance given by the CAG and his office to the Financial Committees is in effect /assistance to the entire legislature. Even in regard to those issues dealt with in the audit reports which have not been taken up by the committees for detailed oral or other examination, notes on remedial action taken by individual departments of government are required to be submitted to the committees, after the notes are vetted by the Audit Department.

The Public Undertakings Committee of Parliament, besides considering some of the reports of Comptroller and Auditor General, carries out its own examination of the working of a number of public commercial enterprises. There is a need here for closer coordination between the CAG and the Committee in selection of the subjects for audit appraisals of public undertakings to avoid duplication of efforts.

2.4.3 Auditing Standards

As pointed out earlier, the CAG has full authority to determine the scope and extent of his audit. The auditing standards followed in India have evolved over many years during which state audit has been /practised in this country. These auditing standards have been incorporated in various manuals issued by the CAG for the guidance of his officers. Specific criteria and procedures of audit have also been laid down in separate manuals or various audit disciplines.

In the audit of the financial statements of commercial departments of the government or of the many public enterprises, Generally Accepted Auditing Standards (GAAS) as applicable to comparable enterprises in private sector are observed. The CAG has, however, the right to issue directions to the professional accountants who conduct the primary audit of public sector

companies, indicating to them the manner in which the audit of such enterprises is to be conducted. The CAG also reviews the performance of such auditors.

2.5 □ Weakness of The Existing System in the Context of its Functions :

1. One of the primary functions of audit is to see that provisions of law, rules and regulation are properly applied while incurring expenditure or collecting revenue. In order to regulate usage of money elaborate rules and regulations have been drawn by government. While audit notices systematic violation of law, rules and regulations by departmental officers it is unable to take an effective action to prevent them.

The Bihar fodder scam will illustrate the point. Serious financial irregularities and misappropriation of government funds were being committed by senior government functionaries and the Treasury officials all acting together in collusion. The Accountant General (AG) Bihar could not detect the irregularity in time as Treasury officers suppressed the vouchers through which money was drawn and / did not transmit them to AG thus preventing its audit. C&AG has been making mention of excess drawl over voted provision in its Audit Report presented to Bihar Legislature but Public Accounts Committee, it is said did not even met to discuss the report leave apart take preventive action. After the scam became public knowledge, C&AG has produced a well documented Audit Report but it is more a case of getting wise after the event.

Section 13 of the Comptroller and Auditor General's Act, lays down that it is the duty of audit: to ascertain that the money, which has been disbursed was legally available for the service or purpose on which it has been applied and there is a proper authority to spend the money. What happens when a public official spends money, which is not legally available viz., it is in violation of laid down rules and regulations. The Act is silent about it - all that the last sentence of Section 13 says, " in each case to report on the expenditure, transaction or accounts so audited by him." If the C&AG makes a report about the irregular usage of money to the Departments whose officials have committed the default and they contest C&AG's decision or do not take any action, C&AG finds itself in such a helpless situation.

2.5.1 □ Position in Advanced Countries

Most Supreme Audit Institutions (SAI) have been vested with powers to fix responsibility on the officials who have caused loss to the exchequer and have legal power for its recovery.

In *New Zealand* under the Public Finance Act of 1977, the Controller and Auditor General (CAG) is empowered to hold an enquiry which may require any evidence to be given either orally or in writing and to which the provisions of Crimes Act relating to perjury applies. The CAG has power for surcharge if he finds that there is deficiency or loss of money or store caused through fraud, mistake, default, negligence, error or improper or unauthorized use.

In *Japan* the Board of Audit has powers to adjudicate and can order an official to indemnify the loss and direct the supervising officer to take disciplinary action against the delinquent official when it finds that the official has caused grave loss to the State either deliberately or by gross negligence.

In *France* Cour des Comptes which functions like a court may order accounting officers to settle uncollected revenue or irregular expenses out of their own resources, if during an investigation it finds that the accounting officer has failed to provide satisfactory justification- on the ground that they have formal personal responsibility. Hindering Cour's investigation may give rise to a monetary fine. The judgements of Cour are legally binding and can be appealed only on points of law.

In *South Korea*, the Board of Audit and Inspection (BAI) law, confers authority to the Board to examine and adjudicate whether an accounting official or any other person is liable for reparation and the manner in which recovery is to be made and execute collection by applying mutatis mutandis provisions concerning disposition of taxes in arrears in the National Tax Collection Act.

In *China* under the State Audit Act, an audited unit violating financial and economic laws and regulations, the audit organs may confiscate or instruct them to return the illegal gain; take over the embezzled state assets; take decisions to cut off such appropriations or loans; and impose fines.

In *Thailand* under the State Audit Act of 1979, Auditor General can summon an official to deliver accounts and registers; attach money, properties, accounts registers, documents etc. of the audited agency and summon a person to testify as witness. If a person who has the duty to keep in his custody money or property or documents etc., damages, destroys, or causes loss he is liable for imprisonment upto five years or a fine or both. The

Auditor General and the competent officials while performing their duties under the State Audit Act are treated as officials under the Penal Code.

Conferring Legal Powers - An effective remedy

The situation in our country needs to be remedied by conferring legal power to Audit Officers. Suitable provisions in the C&AG's Act are to be included to enable them to implement their findings. The Act should entrust Audit Officers with following powers:

- (a) Powers to summon the concerned officers before it for evidence on oath and where default is established, after giving due opportunity, they be required to make up the loss,
- (b) In case the official does not make up the loss and the default or neglect is established, a report be made to the superior authority of the department where officer is working for taking disciplinary action under the Civil Services Conduct Rule.
- (c) Where action of public official involves criminal liability, the public prosecutor be informed either by Audit official or by the Department to which he belongs for initiating criminal action under the Penal code. For discharging this quasi-judicial function the powers similar to those available under Commission of Enquiry Act be vested with the Accountant General / Principal Director of Audit who are heads of department by making suitable legal provision to that effect.
- (d) To make the system transparent and fair there should also be a provision of appeal with final appellate stage at the level of Additional / Deputy Comptroller and Auditor General at the headquarters of C&AG's office.
- (e) It is for consideration whether a Constitutional provision be made, that all bodies which are publicly funded, fall within the audit mandate of Comptroller and Auditor General and any stipulation, which ousts his jurisdiction would be held ultra-vires.

● Position in other Federal Countries

Every country with federal structure has a provision of separate Auditor General for the provinces states.

Thus in **Germany** the Federal Court of Audit (FCA) and the constituent states known as *Leander* are autonomous independent unit of government audit. They not subordinate to one another, share audit responsibilities and may perform joint audits.

In USA the General Accounting Office performs audit of federal government only. There is Auditor General in each State who enjoys separate legal status and is free to devise his systems to make his audit effective.

Similar is the position in **Canada** and **Australia** where an act specifies provincial Auditor General's responsibility to examine the accounts of the province and its various agencies and requirement to report to the Assembly on the governments stewardship of public funds.

In **UK**, despite being a unitary state CAG audits central government expenditure only. Following devolution in 1999, new Auditor Generals have been set up in Scotland and Wales to audit the expenditure of new Parliament and Assembly. There has been a separate Comptroller and Auditor General for Northern Ireland since the foundation of the state in 1921.

It is therefore for consideration that in order to make State audit effective independent Auditor Generals for the States who have the same status as a High Court Judges are created by amending the Constitution. The appointment of State Auditor General be made with the approval of President of India on the basis of recommendations of an independent Committee headed by C&AG and qualification for holding the post be laid down. However the Auditor General of India should have power of superintendence over State Auditor Generals, in policy matters relating to accounts and audit, same manner that Court has over the High Courts.

Even if separate Auditor General's for State's are created, the existing status of IA&AS need not be disturbed and its members continue to be posted in the Accountant General's / Auditor General's offices as hitherto, on the basis of a policy evolved through Audit Services Board (comprising of representatives of CAG and State Auditor General's) which could be constituted for the purpose. Their current status of staff serving in the IAAD need not be changed, and they may continue to be Central government servants. However, the newly created State Auditor General's, will have final say regarding their recruitment, promotion, transfer etc within some kind of uniform policy which could be worked out by consultation amongst CAG's office and the State Auditor General's.

If Indian Audit and Accounts Department (IAAD) is to be given more teeth to be effective it must ensure very high standards of performance. Administrative departments often voice criticism of the manner of functioning of Audit department. They point out that audit often takes trivial objections,

does petty fogging, and has a negative fault finding approach rather than coming out with solutions to the problems being faced by administration. Audit is also criticised for preparing reviews on the working of scientific and technical departments and on issues relating to economic policy making about which it has no expertise. There is considerable merit in these observations.

Much of the problems arise due to the existing structure of IAAD, which is highly centralised with all powers concentrated with C&AG in person or in his headquarter office with very little delegation to State Accountants Generals or Principal Directors of Audit who perform all the accounting and auditing functions. This tells upon the efficiency of the State Accountant's General and other field outfits and effects their morale. The problem can be seen from the fact the C&AG personally approves about 20 Audit Reports for Union Government and 75 Reports for State Governments. In addition C&AG has to certify Finance and Appropriation accounts of the Union government as well as each of the State governments and UT's having a separate legislature before they are placed in their respective Houses. Each of about 100 odd Audit Reports of the Central and State governments which the C&AG produces annually runs into 200 to 250 pages. It is humanly not possible to read through 20000 to 25000 pages of highly technical literature dealing with subjects as complicated as taxation laws, purchase of defence equipment etc., least of all to give any direction regarding meaningful conduct of audit. It is time to do some serious thinking on the issue and develop a more decentralised functioning of the institution of C&AG.

Need For Collegiate Decision : Audit Commission

In most advanced democratic countries Audit Reports which are placed in Parliament are finalised through an Audit Board or Audit Commission system in which all the senior officers of the state audit department are represented.

In **Germany**, the Federal Court of Audit enjoys judicial independence and a constitutional status similar to that of judges. The Large Senate which is the main decision making body consists of 16 members and includes President, Vice President and the Directors of Audit.

In **France** the Cour des Comptes is presided by Premier President and has seven chambers with 15 members. The Cour always acts as a collegiate body, whether in a judicial or non-judicial capacity. The draft annual reports

on the accounts of the state and the management of the state services, agencies and companies are brought before the complete bench presided over by the President of the Court.

In **Japan** there is an Audit Commission consisting of three Commissioners. The Audit Commission including finalisation of the Audit report takes all major decisions pertaining to audit.

In **Korea** the Board of Audit is composed of seven Commissioners including the chairman. Decisions on policy issues, such as audit and inspection are taken with the approval of the Council of Commissioners.

In our country there is no system of finalisation of audit reports through a formal committee system in which the Deputy CAG/Accountant General / Principal Directors of Audit participate. The audit reports both of the Central and State governments are processed on files by the Deputy CAG and Additional Deputy CAG and approval of C&AG is taken. The expenditure and revenue transactions of the government have increased hundred folds with tremendous growth in government's activities after independence. It is simply not possible for one individual viz. C&AG to be responsible for all audit work of Central as well as State government. There is need for wider sharing of responsibility. The existing system results in neglect of audit and poor quality of Audit Reports. There is also no system of discussion with Secretaries to government / heads of department before the Audit report is finalised. This leaves yawning gap in the Report, facts and conclusions are often challenged with the result that the main purpose of audit viz. improvement of the administrative set-up and the systems and procedure takes a back seat.

The existing system needs an overhaul. Audit Reports should be finalised through collegiate decision making of an Audit Commission in which all the Deputy CAG's and Additional Deputy CAG's should be represented besides C&AG. The position of C&AG should be that of *primus inter pares*. For proposed Audit Commission to be effective its members should be given a status similar to that of a High Court Judge with age of retirement as 62.

2.5.2 □ Quality of Audit-Problems Due to C & AG's Highly Centralized Set-Up

Most of the problems of the Indian Audit & Accounts department arise from the fact that the organisational structure of C&AG is not in consonance

with the federal arrangement as envisaged in the Constitution. While we have a separate Legislature, Governor and a High Court in every State there is no Separate Auditor General. It is important to remember that the Constitution makers were conscious of this fact and draft Constitution as originally prepared had recommended separate Auditor General for every State. The original draft prepared by the drafting Committee, headed by Dr B R Ambedkar and submitted to the President of the Constituent Assembly on 21st May 1948, contained the following provision:

Auditors-in-Chief for the States-Art 210(1) - The Legislature of the State for the time being specified in the First Schedule may by law provide for the appointment of an Auditor-in-Chief for the State and when such a provision has been made an Auditor- in Chief for that State may be appointed by the Governor in his discretion and the Auditor -in-Chief so appointed shall only be removed from office in the manner and like grounds as a judge of the High Court of the State." The draft Constitution had a provision for control of Auditor General of India over State Auditor General. Art 210(6) read as follows : " Nothing in this article shall derogate from the power of the Auditor General of India to give such directions in respect of the accounts of the States for the time being specified in Part I of the first schedule as are mentioned in article 126 of this Constitution." The drafting committee had made the aforesaid provision on the basis of Government of India Act of 1935 which had envisaged separate Auditor General for the Provinces.

The provision of draft Constitution was amended at the stage when draft articles came for approval of Constituent Assembly based on the recommendation of an Expert Committee that suggested doing away with provision of Provincial Auditor General.

As stated above the provision for a separate Auditor General for the States was deleted at the stage of final passing of the draft Constitution. Nevertheless for audit of State finances the C&AG has to be accountable to State legislature and this was secured by inserting a provision in Article 148 and 149 of the Constitution stating that the Auditor General of Union will perform duties in relation to accounts of the States', and ' his reports will be submitted to the Governor of the State, who shall cause them to be laid before the Legislature of the States'. This position is somewhat anomalous. If C&AG is to perform duties in relation to Accounts of the State he should be available to State legislature and attend meetings of the State Public Accounts Committee. But one single individual cannot discharge this function

for 25 States. As matters stand today the Accountant General of the State discharges all the duties prescribed in the Constitution on behalf of the C&AG. Given this position, it is imperative that a legal provision is made to this effect.

3. C & AG And Parliament Interface

In parliamentary democratic form State audit tends to be classified as part of the legislative branch as the institution has developed over time to implement the power of the purse. State audit with its access to information and review of governmental activities, fulfills an increasingly important role in providing legislature with detailed reliable information necessary for control. A realisation of this fact has lead to major structuring of the audit department in U.K with the passing of the National Audit Act of 1983. Under the act C&AG has been made an officer of the House of Commons. Another Commonwealth country **Australia** has fallen in line with British system and under a 1997 act Auditor General will be an independent officer of Parliament. In U.S.A the General Accounting Office from the time of its constitution in 1921, has been recognized as an agency within the legislative branch of the government and enjoys a special working relationship with the American Congress.

● Relations with Public Accounts Committee in India

The Comptroller & Auditor General audits the accounts and submits his Report to Parliament / State Legislature which are automatically remitted to the Public Accounts Committee(PAC) / Committee on Public Undertakings(COPU). Parliament has constituted PAC and COPU under Rule 308(1) and Rule 312 A of the Rule of Procedure and Conduct of Business of Lok Sabha.

● Violation of Constitutional Provision - Excess Expenditure

In many States PAC's have not been able to discharge even the Constitutional obligation of regularising "excess expenditure" over budgetary grants. Under Article 205(b) of the Constitution, if any money has been spent on any service in excess of the amount granted for that service in the Annual Financial Statement, it would need regularisation by the Legislative Assembly. Under the Rules of Business framed by the Legislatures, the PAC examines

the explanatory notes furnished by the Ministry/ department and the circumstances leading to such excesses and presents a report to the Legislature recommending regularisation of excess expenditure. As on March 1999 Excess expenditure" of the order of about Rs 94314 crs has not been regularised in various States. The position of some of the States is as follows : J&K: Rs 22767crs, UP :Rs 13618crs , Assam : Rs 12569crs , Bihar :RS 6059 crs. Thus in almost all the States huge amount of public money has been spent in violation of budgetary control envisaged in the Constitution and fraught with the risk of misappropriation of public money.

There is no time limit prescribed for placing Appropriation Accounts certified by Comptroller and Auditor General in Parliament/ State Legislature and the regularisation of excess expenditure over voted grants by the PAC. There is need for making statutory provision regarding the dates by which Appropriation Accounts is submitted to Parliament/ Legislature. The Controller General of Accounts/ Accountant General should submit the same to CAG by 30th September and CAG should certify and arrange to place --- in Parliament/ Legislature by 30th December of the following year to which the accounts relate. It is also for consideration whether a provision needs to be made that excess expenditure over voted grant be regularised by PAC/ Parliament/Legislature before the close of next financial

the Act, the Treasury is required to submit accounts to Auditor General by 30 September and he is required to present to Parliament by January of the following year in- elate. In New Zealand under the Public Finance Act ary required to forward the annual financial statement to y 30 ugust following the end of the financial year and s req to give its opinion within 30 days of receipt and be t in the House within six days of receipt by the

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PAC and COPU are able to examine
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which the Parliament is required to
of 16 Reports submitted to Parliament
number of paras / reviews selected for
16 could be discussed by the PAC.

In States there is a huge backlog of work before the PAC's.

In order to strengthen parliamentary control over executive it is necessary to devise a system which envisages that PAC examines all the reports submitted by CAG and submits its recommendations to Legislature within a time limit of say 18 months. This is possible only if the volume of CAG's Audit reports is reduced and their quality and content improved and only matters of critical importance are included in the Audit Reports. (Other financial irregularities noticed during audit need to be settled with the concerned Ministries/ departments through forums such as Audit Committees which need to be devised in consultation with Ministry of Finance). For PAC to function effectively and its members to develop specialisation, the life of PAC be made five years co-extensive with the life of Parliament/ State legislature with one-third of members retiring every year. It for consideration whether PAC be given a Constitutional status with clearly defined mandate, duties and functions.

It is also, for consideration whether C&AG should be made an officer of the Lok Sabha so that he could work in greater cooperation with Parliament and its Finance committees with a view to make parliamentary financial control more effective.

2.5.4. Accountability Of C&AG - External Audit

The importance of audit process, and what it entails by way of resources deployed by agencies subject to audit, underlines the importance of subjecting the State audit to regular and perceptive scrutiny. It is necessary that State audit demonstrates that its own operations stand the test of professional soundness, efficiency and effectiveness.

In India there is no external audit of C&AG's outfit. In practice C&AG nominates one of the Accountant General under him as an auditor for C&AG's office. This is not a very satisfactory arrangement. Commonwealth countries such as U.K and Australia have made legal provision not only for audit of National Audit Office by independent auditors but scrutiny of budget estimates by a parliamentary committee which oversees its functioning. *It is for consideration whether an external audit arrangement be made C&AG's set-up in line with the practice in UK.*

Module -III ● Unit-3 □ The National Accounting System

Structure

- 3.1 Introduction
- 3.2 Type of Accounting system
- 3.3 Classification of Transactions
- 3.4 Main Divisions of Accounts
- 3.5 Accounting Standards
- 3.6 Production of the Accounts
 - 3.6.1 Steps in the Accounting process
 - 3.6.2 Format of the public Accounts
- 3.7 References
- 3.8 Exercises

3.1 □ Introduction

One the most distinctive features of the system of Government Accounts in India is the minuv elaboration of the financial transactions of Government. Both receipts and payments, are differentiated and classified in detail. Further, the uniform classification of transactions enables financial comparisons between Union and State governments.

The following three developments are worth mentioning in this context:

1. In view of major public investments by way of plan outlay, government accounts were required to reflect clearly the expenditures incurred on various schemes, programmes and projects, i.e. to conform with plan heads of expenditure.
2. The Parliament and State Legislatures in addition to the general public, became increasingly conscious about government accountability.
3. The government, as a policy maker and as a manager of national finances, became more conscious about the use of government accounts as a tool for obtaining adequate and timely inputs for the rmep'oses of evaluation, remedial action and future policy decisions.

These developments resulted in the government accounting authorities making the following responses:

- (i) Preparation of aggregate accounts [Finance and Appropriation Accounts]

with not only adequate financial and accounting data but (a) with a critical analysis of the financial performance of the government, (b) highlighting deviations from the expenditure incurred in contravention of approved appropriations, and (c) verifying the veracity of explanations offered by the executing agencies; and

- (ii) Greater use of EDP methods for the purposes of accelerating the process of availability of final accounts and for quick retrieval of need-based information.

The major information inputs provided by the accounting authorities to the government are in the form of:- (a) Monthly and Annual Accounts, (b) Finance Accounts, (c) Appropriation Accounts and, additionally (d) Combined Finance and Revenue Accounts.

3.2 □ Type Of Accounting System

The government accounts in India are kept on a cash basis. Therefore, only actual receipts and payments during the financial year are taken into account with no outstanding liabilities or accrued income included. All cash appropriations lapse at the close of the financial year.

Although the government accounts are maintained on cash basis, a need has been felt for maintaining the relevant accounts on a commercial basis (reflecting accrual accounting) in the case of those government departments where functions are purely or largely of a commercial nature. For this purpose draft accounts are kept on commercial accounting principles for those commercial units under a ministry or department. For the major government commercial departments-such as Railways, and Posts and Telecommunications-detailed capital and revenue accounts are prepared and presented separately. This enables the public to see the complete picture inter alia about cost of services rendered and the return from investments.

While the question of government accounts being maintained on an accrual basis was being discussed and considered, it lost a great deal of its relevance in view of the emergence of a very large public sector in India. In compliance with the policy of the government to have a planned economy, massive investments have been made by the Government in various public enterprises. Since a large segment of governmental activity of a commercial, industrial and trading nature is being carried out by public enterprises based on commercial principles, the objective of accrual accounting is inherent in the model adopted.

3.3 □ Classification Of Transactions

The conventional pattern of classification followed organizational lines, consisting mainly of the listing of receipts by various types of taxes, and expenditures by reference to the spending department rather than to its objects or purposes. With the phenomenal growth and diversity in the functions of governments involving huge outlays, accounts acquired a new dimension. Accordingly, the necessity for a more meaningful classification of transactions for presentation of government operations in terms of functions, programmes and activities became increasingly apparent. A study team subsequently established by the Government of India, with the Deputy Comptroller and Auditor General as convenor investigated the feasibility of devising a uniform classification for the budget, accounts and plan, and of presenting the objectives and purposes of government expenditure clearly in terms of functions, programmes and activities. Following the recommendations, the classification of transactions on a functional basis was introduced from 1 April 1974.

While the functional approach to classification is now well established, the divergence between plan programmes and accounting classification increased over the years. To bring about a closer correlation between plan schemes and Accounts Heads, the government constituted a committee which included a representative of CAG to review the existing classification and rationalise the Account Heads where required. As a result of this review in consultation with the CAG, the new accounting classification came into force from 1 April 1987. While the basic principles and broad structure of accounts were retained, certain new sub-sectors were introduced, a new coding pattern was devised and other changes initiated so that expenditure on plan programmes could be extracted directly from the accounts. The list of Major and Minor Heads of Accounts of Union and States published by the Government of India gives the relevant details.

3.4 □ Main Divisions Of Accounts

Following constitutional requirements government accounts are maintained in the following three categories:

- Part I—Consolidated Fund (Art. 266 of Indian Constitution)
- Part II—Contingency Fund (Art. 267 of Indian Constitution)
- Part III—Public Account (Art. 266 of Indian Constitution)

Article 283 of Indian Constitution deals with the custody etc. of consolidated fund, contingency fund and public account.

In Part I, there are two main divisions of the Consolidated Fund. The first division comprises the section 'Receipt heads (Revenue Account)' dealing with the proceeds of taxation and other receipts classed as revenue and the section 'Expenditure heads (Revenue Account)' dealing with expenditure met therefrom. The second division comprises the following sections :

- (a) The section 'Receipt heads (Capital Account)' which deals with receipts of a Capital nature which cannot be applied as a set off to Capital Expenditure;
- (b) The section 'Expenditure heads (Capital Account)' which deals with expenditure met usually from borrowed funds with the object either of increasing concrete assets of a material and permanent character or of reducing recurring liabilities. It also includes receipts of a Capital nature intended to be applied as set off to Capital expenditure; and
- (c) The sections 'Public Debt' and 'Loans and Advances', which comprise loans raised and their repayments such as internal debt, external debt and their recoveries.

In Part II, the transactions connected with the Contingency Fund set up by the Government of India or of a State are recorded. To complete the classification, Part III shows transactions relating to Debt (other than those included in Part I), 'Deposits', 'Advances', 'Remittances' and 'Suspense'.

Within each of the divisions and sections of the consolidated fund, the various transactions are grouped into sectors, such as 'General Services', 'Social Services' and 'Economic Services'. These sectors have sub-sectors before their division into Major Heads of Account. In Part II- (Contingency Fund), there is a single Major Head to accommodate all transactions of the Contingency Fund. In the case of Part III (Public Account), transactions are grouped according to sectors and sub-sectors which are further sub-divided into Major Heads of Account.

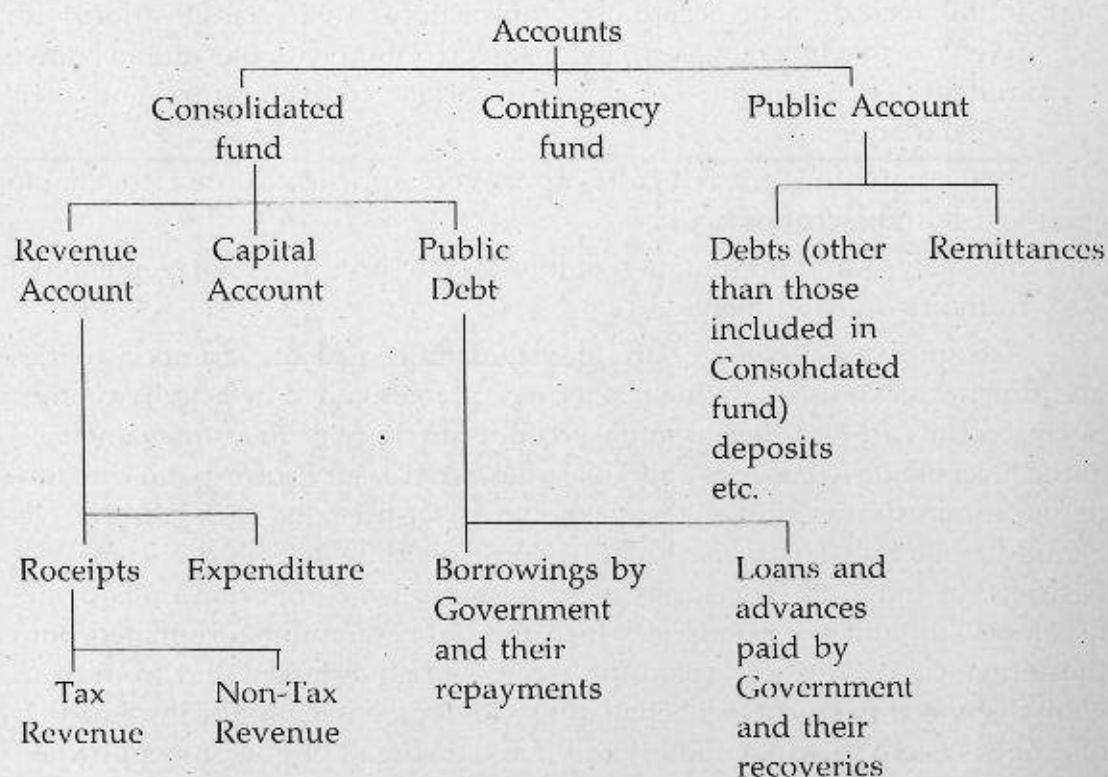
3.5 □ Accounting Standards

The Constitution envisages that the accounts of the Union and the States are to be kept in such a form as the President may on the advice of the CAG prescribe. The word 'form' has a comprehensive meaning that includes the prescription not only of the broad form in which the accounts are to be kept

but also the appropriate heads under which certain transactions or classes of transactions have to be entered, Accordingly accounting standards have been established in rules and regulations mandated by the Union Govt. on the advice of the CAG.

As regards the accounts of public enterprises and departmental commercial organizations, the Indian Companies Act and professional accounting bodies prescribe accounting standards. The Institute of Chartered Accountants of India accordingly has issued accounting standards, which are implemented where relevant in this context. A representative of the CAG is generally associated with the standards setting process.

The broad accounting structure is shown in following figure



3.6 □ Production of The Accounts

Initially the CAG had the responsibility of compiling and maintaining the accounts of the Union and the States. He has now been relieved of this responsibility for the Union. The annual accounts in relation to Railways,

Defence, Post and Telecommunications are produced by the respective departments of the Government of India. The Appropriation Accounts of the remaining departments and the Finance Accounts of the Government of India as a whole are produced by the Ministry of Finance. Responsibility for the production of the annual accounts of the State Governments is vested in the Accountants General who are officers under the CAG.

3.6.1 Steps in the accounting process

In view of the vast size of the country and widespread activities of the government, both at the Union and the State levels, the task of maintaining Government Accounts is indeed a formidable one. The process involves:

- (a) initial recording of accounting transactions, their classification with reference to a function or activity, their correlation with the administrative ministry/department, i.e. the appropriate control centre and their consolidation;
- (b) their matching with legally approved appropriations (to enable legislative scrutiny); and
- (c) the analysis and presentation of this data to serve as a management tool to the two governments.

Accounts, as elsewhere, are a systematic record of various activities and functions expressed in financial terms and maintained by activity centres. Such accounts are classified as initial accounts. In the State they are maintained at the level of Sub-Treasuries and Treasuries. (A Treasury corresponds broadly to one administrative unit of a State known as 'District' and each 'District' has a number of Sub-Treasuries; broadly corresponding to sub-divisions of a District). In India the Treasuries were formerly very important units of the fiscal system, and the points at which the public accounts originated. Into these financial centres were paid the receipts of government and from them were disbursed payments on behalf of the Government. Until the introduction of a new system (discussed later) and marked spread of government owned banks, Treasuries and Sub-treasuries were widely dispersed, functioning as bankers to the government, with the Reserve Bank of India at the apex. Later another major bank of the country (State Bank of India) commenced operations with many branches as a supplementary agency of the Reserve Bank of India. The cash balances of the Treasuries formed part of the Government Account. After 1975, two major developments took place :

- (i) The cash functions of the Treasuries and Sub-treasuries were largely entrusted to government owned banks and their branches, and
- (ii) With the establishment of a separate departmental accounting organisation in respect of the Union Government Civil Departments, the functions of the Treasuries and Sub-treasuries at the Union level were largely taken over by the Pay and Accounts Offices. These offices are functionally under the control of the Permanent Secretaries of the Government, but administratively they are governed by the new department, viz. Indian Civil Accounts Department under the Ministry of Finance.

As previously mentioned, prior to 1976 responsibility for compiling and consolidating the accounts was not vested in executive departments but in the Accountants General under the aegis of the CAG (except in the case of Defence Department, Railways and a few other departments). With the formation of the new departmental accounting organisation, the responsibility of the Accountants General to maintain the accounts of Union Civil Departments was transferred to the former.

Before these developments took place, the revenue and other receipts and the payments made from Treasuries were recorded and compiled into two separate accounts for the transactions of (i) the Union Government, and (ii) the State Governments. The classification of each item of receipt and payment according to its functional and administrative unit was made by the departmental offices. A list of payments (supported by payment vouchers) was sent by the Treasury Officers to the Accountant General twice a month and that of receipts once a month. Detailed rules were framed for the payment of moneys into and withdrawal of moneys from the Treasuries and their accounting.

In the case of departments such as Railways, Posts and Telegraphs, Defence, Public Works and Forest the receipts realised were paid into the Treasuries in total and accounted for only as receipts of those departments. The detailed accounts of such receipts were kept by the departmental offices concerned. Similarly, sums withdrawn from the Treasuries (or a linked bank) by those departmental offices appeared in the Treasury accounts merely as payments on behalf of those departments-detailed accounts being maintained by the departmental offices. From the initial accounts supported by payment vouchers rendered by the various treasuries and other departmental offices,

the Accountants General compiled and consolidated the accounts in the form of Appropriation and Finance Accounts.

The accounting position changed considerably after 1976. While the Accountants General, as functionaries of the CAG, are still compiling and maintaining the final Government Accounts at the State level, the responsibility at the Union level no longer lies with the Accountants General. This has been transferred to a separate functionary, namely, the Controller General of Civil Accounts. Similarly functions of the Treasuries and Sub-treasuries, as recipients and disbursers of cash, have largely been transferred to the banks, while at the Union level the Treasuries have practically ceased to play any effective fiscal role.

The Government Accounts have necessarily to comply with the budgetary structure of the country. Since budgets in India are on an annual basis, governmental transactions are also finalised in the accounts on an annual basis. However, the government Accounts of each financial year are kept open for a certain period in the following year for adjusting transactions which took place in the previous financial year. This is considered necessary in order to allow certain inter-departmental adjustments, corrections of misclassifications, clearance of certain transitory heads (Suspense Heads), and other relevant adjustments.

3.6.2 Format of The Public Accounts

❑ **FINANCE ACCOUNTS** : These accounts show the receipts and outgoings of the government for the year, together with the financial results disclosed by the revenue and capital accounts, the accounts relating to public debt, and liability and assets of the government. The Finance Accounts are generally prepared in two parts:

Part I - Summarised Statements

Part II - Detailed Accounts and Other Statements.

❑ **APPROPRIATION ACCOUNTS** : These are accounts of the expenditure, voted and charged, of the government for each financial year compared with the amounts of the voted grants and appropriations charged for different purposes as specified in the schedules appended to the Appropriation Acts. These accounts are complementary to the above accounts of the annual receipts and disbursements of government (Finance Accounts).

□ COMBINED FINANCE AND REVENUE ACCOUNTS OF THE CENTRAL AND STATE GOVERNMENTS IN INDIA : These present the accounts of all governments in India on a common and comparable basis. They are prepared by the CAG, mainly from the figures contained in the respective Finance Accounts of the governments.

● Conclusion

In India financial accountability and fiscal management systems covering budgeting, accounting and auditing, have evolved over more than a century.

This evolution has been in response to the changes in the political, social and economic environments nationally during this period. However the budget as an instrument of planned development and accounting as an aid to decision-making are relatively new concepts. Similarly, the transformation of audit from a relatively simple device to ensure mere regularity of government expenditure against budget appropriations in a colonial situation to an important organ of the democratic polity, engaged in sophisticated performance evaluation of public financial operations in a planned economy, is a phenomenon of post-Independent India.

Future reforms in the systems will have to address, among other things, the development of comprehensive management accounting and information systems capable of achieving effective financial control and accountability. With the vast increase in the financial transactions and their reflective activity centres adequate and reliable internal audit arrangements have to be instituted or strengthened. Further, a climate conducive to appropriate administrative responsiveness to the requirements of effective financial management, accounting and auditing will have to be created.

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3.8 □ Exercises

1. Public response is sought to be elicited for making major reforms in the institution of C&AG to make its functioning more effective:
 - a) Should the appointment of C&AG be taken out of the exclusive purview of Executive and a high level independent committee consisting of Prime Minister, Finance Minister, Leader of Opposition in Lok Sabha and Chairman of Public Accounts Committee be constituted to select him?
 - b) Should qualification for the post of Comptroller and Auditor General be laid down and persons having extensive experience of the functioning of public audit and accounts systems should only be eligible to hold the office?
2. Countries having federal structure such as USA, Germany, Canada, Australia and now U.K have separate Auditor General's for provinces. Should public audit systems conform to the federal structure of our country and constitutional status and autonomy be given to the State Accountant General and his status made equivalent to a High Court Judge so that he can effectively discharge his responsibility to the State Legislature? In that case should he be appointed by the President of India on the recommendations of an independent committee headed by Comptroller and Auditor General?
3. Countries such as Germany, France, Japan and South Korea work through a system of Audit Court / Audit Board with members enjoying high legal status with President of the Court / Board's position that of primus inter pares. Should the office of CA&G be restructured and broad based by creating an Audit Commission which should have existing Dy CAG's enjoying the status of High Court Judge as members and function on the principle of collegiate decision for all policy matters relating to audit and accounts?
4. Audit officers in most countries such as New Zealand, Japan, Germany, France, Korea, China and Thailand have been entrusted with judicial powers so that they ensure that State money and property is safeguarded. Should quasi-judicial powers as available under Commission of Enquiry Act be given to senior officers of the Audit department who should have authority to summon public officials to give evidence on oath, surcharge them if they find that he has caused

loss of State money and property through fraud, negligence and improper use and if that is not possible advise the Department where they are working to take disciplinary action under the Conduct Rules?

5. Presently Public Corporations in the banking and financial sector do not fall within the jurisdiction of Comptroller and Auditor General's audit. However, government companies are subject to state audit under the Companies Act. Are public enterprises at a disadvantage due to presence of C&AG's audit in the context of globalisation and competition and a level playing field is not available to them? What should be the audit arrangement for Public Enterprises which should fulfill requirements of public accountability without impairing their commercial autonomy?
6. With the policy of progressive empowerment of the local self-governing institutions receiving a greater emphasis with attendant prospect of sizable percentage of State funds being handled by these/institutions, appropriate public audit mechanism needs to be considered. What should be the accounting and audit arrangement of Panchayats and Municipalities and whether a Central legislation be enacted, with Comptroller and Auditor General (or the proposed Auditor General for the States) having authority to lay down accounting and auditing standards and general superintendence over such audit?
7. Public Accounts Committee's have not been functioning effectively and most of the reports of C&AG remitted to it remain unexamined defeating the principle of parliamentary control over public funds prescribed under the Constitution. In the States a sum of over Rs 94000 crs of "excess expenditure" over voted Grants is awaiting regularisation under Article 205(b) of the Constitution. To make the functioning of PAC effective should a time-limit, of say 18 months be prescribed, for it to examine the reports of C&AG and submit its recommendations? To develop expertise should the life of PAC be made five years, co-extensive with the term of legislature, with one-third of its members retiring every year. Should Constitutional status be given to Public Accounts Committee with clearly defined duties and responsibilities.
8. Public audit institutions tend to be classified as part of legislative branch as they help legislature to implement power of the purse. In U.K. and Australia C&AG has been made an officer of the House of Commons. What should be the relationship between C&AG and Parliament. Should

practice similar to UK be followed in our country?

9. In UK Public Accounts Commission examines the budget and appoints the auditor of the National Audit Office. What should be the arrangement for audit of the office of the Comptroller and Auditor General? Should an external agency be entrusted this task to make the system transparent?
10. Write a note on stages of an audit.
11. Write a note on the appointment and functions of CAG in India.
12. Write a note on the role of the Supreme Audit Institution (Sai)
13. What are the Monitoring Mechanisms ?
14. Examine the weakness of the existing system in the context of its functions.
15. Evaluate the quality of Audit- Problems Due to C & AG's Highly Centralized Set-Up.

● **Short Questions :**

1. How a system's internal control is done?
2. What is auditing ?
3. What is 3E's Audit?
4. What is known as Performance audit ?
5. Name some significant Global Audit Firms.

Module-IV ● Parliamentary Control Over Financial Administration □ Unit - I Budget Approval

Structure

- 1.1 Introduction**
- 1.2 Public Accounts Committee**
- 1.3 Other Parliamentary Committee**
- 1.4 Estimates Committee**
- 1.5 Other Financial Committee**

1.1 □ Introduction

Just as a household cannot be managed without fund, government as the manager of the society can't function without an assured source of fund. The government mobilizes resources through taxation, fees and charges and other means. The revenue thus raised is society's or public's money. There is, therefore, a latent understanding that the society is providing fund to government on condition that money so raised from society will be properly spent for public purposes. In the developing countries, government has been responsible for a large number of functions and the private sector is not large enough and unable to undertake most public functions nor can it subserve 'public interest'. Government in developing countries has to raise more and more resources from a variety of sources both for 'maintenance' and 'development' functions. The public sphere has thus expanded over the years to a great extent.

The contemporary trend is toward limiting the public sphere and handing over more and more activities to the private sector. To the extent this will be possible, government activities will shrink, and there will be less demand on society to pay for government-run activities. In fact, government expenditure burden will be much less, and hence, government will not be raising more and more revenue from the society. This new philosophy of 'state minimalism' can be traced to what is known as the "Right" reaction on Thatcherism and Reaganomics, as it originated at the time of Mrs. Thatcher regime in U.K and the Reagan regime in USA. The third world countries are also now being advised by the World Bank and the international funding

agencies to reduce governmental size by unburdening the government and passing on many functions to the private sector. No, doubt, the size of government bureaucracy has increased enormously in the Third World countries due to government take-over of many social and developmental functions. There is surely some scope of reduction in the size of government divesting some of its responsibilities; but the leading role of government in pushing through 'development' and securing a minimum level of quality of life for the general public, specially the poor and the underprivileged, can not be dispensed with. Hence, the state "roll back" theory of the "New Right" philosophy has been taken with a grain of salt so far as the developing countries are concerned.

The lesson of this argument is that government in the Third World countries has to be an efficient financial manager in two senses: One, it has to be prudent in expenditure and must not overtax the society which itself is in the process of growing. Two, the government has to frame well planned policies for overall guidance of the economy including the private sector.

Any discussion on 'financial administration' has to be conducted within this broad understanding of the economy of the developing societies.

Government raises fund from the public to meet "maintenance" expenditure or the running expenses of public administration. Government has also to raise funds for "development" expenditure to create new capital assets like big dam, steel plants, new roads, railways, electricity generating plants etc. Financial administration involves planning of public expenditure and revenues, making funds available for the governmental activities and ensuring the lawful and efficient use of these funds. Under democratic government, the legislature is the body to collect the taxes and authorize expenditure. Financial administration has to see that the legislature is not asked to place more tax burden on the people than what is necessary, and that the money voted for expenditure is used according to its wish and with regard to economy and efficiency.

Financial administration thus forms a crucial aspect of public administration. Most administrative acts have their financial implications. They create a charge on the public exchequer or bring revenues to it. Financial operations may be designed to develop and promote particular public policies. Tariffs may be so shaped as to afford protection to the home industries, or taxation may be so designed as to promote economic equality by the transfer of money from the rich to the poor. Finally, financial

administration raises important issues of administrative organisation and relationships, e.g., what machinery of financial administration there should be or what the relationship between such machinery and administrative authorities should be or who; should have the last word about a proposed item of expenditure, the financial offices or the administrative officers.

Financial administration is a composite term for a number of discrete functions as under:

Preparation of the budget i.e. of the estimates of the revenue and expenditure for the ensuing financial year,

Getting those estimates passed by the legislature or other competent authority,

Execution of the budget i.e. regulation of the expenditure and raising of revenue according to it,

Treasury management i.e. safe custody of the funds a raised and due arrangement for the necessary payments to meet the liabilities, and

Rendering of the accounts by the executive and audit of these accounts.

Budget making is the first step in Government's financial administration. Really speaking, however, the budget comes from the political perceptions of the ruling class. The government in power has some policies, which are reflected in the budget. The term 'Budget' has been derived from a French word, 'Bougette' which means a leather bag or wallet. The term was used in its present sense for the first time in 1873, in a satire directed against Walpole's financial plan for the year. Since then, the term has been used for a financial scheme or statement of annual income and expenditure of the government. Traditional budget acquired the descriptive title of "line item", as the object was put on the left side and the cost on the right sides. As Wildavsky has put it: a budget is "a series of goals with price tags attached."

Budget is document, but a Budget system is one that makes use of a Budget as the central instrument of financial administration. A budget system has three phases.

1. Formulation of the Budget and determination of the authority for the formulation of Budget.
2. Legislative action upon the Budget.
3. Execution of the Budget: putting of the provisions of the Revenue and Appropriation Acts into effect.

Budget Classification

The estimates of receipts are made under three main divisions viz. Revenue Receipts (all direct and indirect taxes, non-tax receipts and interest on loans and advances); Capital Receipts (internal debt, external debt and repayment of loans and advances) and Public Account (debt other than that falling under Capital Receipts, deposits, advances, etc.).

The estimates of expenditure from the Consolidated Fund fall into two categories-Non-plan expenditure and Plan expenditure. Each comprises expenditure on revenue account and on capital account, including loans and Advances separately.

Before the various phases of Budget system are discussed, it is useful to study the essentials of Budget system. Some one must prepare the Budget and submit it to the legislature. The responsibility lies with the Chief Executive who, with the aid and assistance of an expert agency like the Bureau of Budget or the Treasury, prepares the Budget and transmits it to the legislature. The Budget should be accurately and completely prepared and it should state all the facts in detail. The Budget should give a complete picture of government's finances, and it should be so laid out and summarized as to make this picture quite clear to the citizens and the tax payers. The procedure adopted by legislature for the discussion of Budget should not be veiled in secrecy. After the Budget has been passed by the legislature, it should be in use throughout the period to which it applies.

The following steps are taken to see the Budget Through :

- A. First of all, the Political Executive decides the overall financial policy, on the basis of which estimates are prepared. Budget preparation starts from the lowest level. On the basis of instructions from top nodal agency, various administrative agencies prepare their estimates. These sectional estimates are then examined and scrutinised by Departmental Heads and then passed on to officers of the Treasury or the Finance Department. After many meetings and discussions, the proposed expenditure plan is consolidated into a single document, which may be again discussed by the Finance Department and the Political Executive. In the final analysis, the estimates are the work of the Executive Department like the Treasury or Department of Finance.
- B. When prepared, it is submitted to the Legislature with a request for

approval. It is discussed in the Legislature in two parts. First, the expenditure side is disclosed and then the revenues are discussed. All legislatures make extensive use of Committees for the examination of estimates. In the legislature, two separate Bills are passed, one is the Appropriation Bill which is a legal document seeking permission to spend money, the second, Revenue bill which gives authority to impose and collect taxes. After these two bills are passed by the Legislature, the Political Executive seeks to implement it. A Budget which has been approved by the Legislature gives authority to the Executive to spend money so particular items as specified by the Legislature. In this way, parliamentary sovereignty is assured.

It is a fundamental principle that a democratically constituted legislature must have a extensive control over the public finances. Legislature, as the fund-raising and fund-forming authority has the power to levy, abolish, increases or wave tax. It has the final authority to sanction money for expenditure. No tax can be levied or collected and no expenditure can be incurred without parliamentary approval.

The Legislature's Duty is :

- a) a reasonably fair distribution of the total sum which the country can afford to devote to Government expenditure;
- b) To ensure that the money so distributed is used for the purposed for which it was intended with the statutory authority;
- c) To try to secure full value for the money which is distributed. Only a responsible and knowledgeable legislature can perform the above mentioned tasks. That is why the opposition parties are very particular about legislative supervision of public finance.

In the same way, in India the Executive demands money from the Legislature by presenting the Budget and Parliament grants it. The Legislature performs its functions under Executive leadership. All demands for grants and all proposals for taxation come from the Executive and the Legislature gives its approval to these proposals after thorough scrutiny.

The second agency concerning Financial Administration and control is the Executive. Control in matters of policy concerning finance vests in the government as a whole. Government decides the expenditure policy. Questions like pay, pension and provident fund to the officials are all determined by the Government. The Executive performs the policy making

function concerning finance, and then tries to get the approval of the Legislature.

The Finance Department is responsible for the entire Financial Administration of the country. This Department performs a variety of functions. It has control over expenditure of money. It controls and coordinates various spending Department i.e. the annual Budget of the government. Its main business is the proper management of the finances of the country. It exercises vital control and supervision over the expenditure of the government Departments. So, primarily among the Departments of Administration stands the Department of Finance, or Treasury as it is known in England.

In all democracies independent audit of public fund as authorized by legislature is vested in a constitutional authority. Honest and sound finance can be ensured by subjecting the public expenditures to the search light of an independent audit. Auditing is the investigation of and report on the fidelity, legality and efficiency of all financial transactions. The audit of public money is conducted by an independent officer on behalf of the Legislature. When the Legislature has sanctioned money for expenditure, it should also see to it that the money is spent economically, legally and honestly. Parliament has to see that money is not misused or mis-appropriated by officials for their own benefit. In India, Parliament gets the audit of public money conducted by the Comptroller and Auditor General, who is a friend, philosopher and guide of Parliament in this respect.

Finally, two committees of the legislature, commonly known as the Estimates Committee and Public Accounts Committees, suggest economies in expenditure in various Departments of Government, at the estimates stage, i.e., before actual expenditure, and the Public Accounts Committee examines the Appropriation accounts in the light of the audit report of the Comptroller and Auditor General, and draws the attention of the Legislature of financial irregularities which might have occurred and makes suggestion for preventing them in future.

The above mentioned agencies are employed for financial control and administration in the government. The purpose of financial control is to secure honesty and economy in expenditure. Government money is provided by tax-payers. These agencies have to see that the tax-payers' money is rightly and properly used. Public money is a trust, and a rupee is not spent where a paisa would have been sufficient, and that paisa is spent not for the personal gain of any individual, but for the good of the society as a whole.

Thus, efficient Financial Administration is an imperative necessity for every country.

The budget is the most important medium of legislative control over the executive decisions regarding financial allocations of fund. It starts with the control of revenue and expenditure, initiated by the executive. No tax can be collected and no expenditure can be incurred without its prior approval. The finance minister presents the budget proposals in the Lok Sabhas towards the end of February. It is preceded by an economic review portraying the state of the economy during the current financial year. The finance minister presents the budget with a budget speech explaining at length the financial proposals of the government. It is presented in the Rajya Sabha at the same time. Parliament recesses for three days to enable the members to study the budget proposals. On reassembly a general discussions takes place for three days after which demands for grants are voted on the basis of the priority of demands previously agreed to by the leaders. Only the votable items are put to vote. Motions may be moved to reduce any grant. On the last day all the remaining items are put to vote. Voting on demands grants is followed by the Appropriation Bill authorizing the issue of money from the Consolidated Fund and vesting in the government the authority to draw money from the Consolidated Fund. (As budget proposals may take some time to get legislative approval, a vote on account may be passed providing for the expenditure of a department for about four months in the new financial year. It is open to general discussion in view of the fact that no fiscal decision can be taken without the consent of the people's representatives in the legislative body.)

Amendments to the budget proposals may propose the abolition or the reduction of any new tax nor an increases in the rate of any existing tax. An amended budget proposal is passed by the Lok Sabha and after consideration by the Rajya Sabha it goes to the President for his signature on receipt of which it becomes an Act. However, the President is bound to give his assent in the money bills/ financial bills as it is proposed by the executive with his prior approval as specified in the constitution.

Budget proposals include taxation, borrowing, or expenditure, especially with one or more of the following matters:

1. 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 obligation undertaken or to be undertaken or to be the Government of India.

- c) The custody of the consolidated Fund or the Contingency Fund of India, the payment of money into or the withdrawal of any money from such Fund;
- d) The appropriation of money to of the Consolidated Fund of India.
- e) The declaring of any expenditure to be expenditure charged on the Consolidated Fund of India;
- f) The receipt of money on account of the Consolidated fund of India or the public account of India or the custody or issue of such money or the audit of the account of the union or of a state; or
- g) Any matter incidental to any of then matters specified in (a) to (g)

Under the Constitution, the executive is to formulate demands for money.

The Lok Sabha has the prerogative to exercise control over taxation, to grant supplies for public expenditure and control appropriations, and public expenditure. This is ensured by the audit of public accounts by an independent statutory authority-the comptroller and auditor-general and the subsequent examination of his audit report by a parliamentary committee-the Public Account Committee. The comptroller and auditor-general examines the annual and satisfies himself that parliamentary grants have been voted and in the amounts intended and they have been spent according to laws, rules and regulations. He reports on any waste, losses or departures from settled financial principles and procedure. This report examined by the PAC completes the cycle of parliamentary control of public expenditure. It is a discretionary audit to ascertain whether the executive has observed the rule of prudent housekeeping in public expenditure.

Four organs of government in a parliamentary democracy-the legislature, the government, the finance ministry and the audit department work together or in interrelated way to deal with public funds.

● Parliament exercises control over revenue, expenditure, borrowing and accounts. Legislative sanction is required for the levy of new taxes, for the withdrawal of money from the Consolidated Fund of for public expenditure, and for the raising of loans.

The discussions relating to the annual budget in Parliament take place in two stages. In the first stage general discussions centre around the budget speech of the Finance Minister. In the second stage, detailed discussions take place on the 'Demands for Grants'.

- The executive, in addition to the legislature exercises control over the finance. It determines the pay allowance, leave, traveling allowance to each of the administrative authorities. The cabinet is assisted by an Economic Committee which decides on the financial matters to be referred to the cabinet for decision. Its secretary reviews with each ministry its financial proposals in the light of the funds available. It coordinates the activities of the government in the government in the economic sphere, determines the priorities of the development schemes in the central and the state spheres and distributes the available resources among the competing schemes. Its orders on the estimates are final.

The budget is the programme of the chief executive. Efficient budgeting depends on the active cooperation of all departments and their subdivision. Each agency should have a budget office. The budgeting and the programming work of the agency should be interrelated under the direct responsibility of the agency head. Each agency has a budgets officer who transmits the agency's views and proposals to the central function; it should permeate the entire administrative structure. The communication between the central office and the agency officers responsible for budgeting and programming is a two-way communication. India is a federal state with a centre and units, each having its own budget. The work on the Union Budget starts with the officers preparing the estimates in September on the basis of the figures supplied by the Finance Ministry. The Finance Department consolidates these estimates in January. They are next scrutinized by the Accountant General.

In the budgetary process, the Ministry of Finance produces a document known as 'The Economic and Functional Classification of the Central Government Budget'. This gives an appreciation of the impact of Government receipts and expenditure on the other sectors of the economy by regrouping the budgetary aggregates in terms of economic magnitudes-for example, the amount spent on capital formation directly by the Government and transferred to other sectors of economy.

- The Finance Ministry has a special responsibility in enforcing economy in expenditure. It has to ensure that the administrative departments get adequate funds, that they deep within their grants, that they surrender their saving will before the close of the year and that the spending departments send progress reports regularly, and on time. It coordinates the activities of

the different ministries, reviews the results and monitors the general trends of government expenditure.

● Public accounts are audited by a statutory authority which is independent of the executive and are scrutinized by the Public Accounts Committee, following the report from the audit department.

All demands for grants and taxation proposals thus emerges from the executive. Expenditure can be sanctioned only by parliament. The Constitution safeguards the interests and rights of the taxpayers through three provisions:

- (i) No tax shall be levied or collected except by authority of law,
- (ii) No expenditure shall be incurred from the public funds except as provided in the Constitution, i.e., unless it has been sanctioned by parliament,
- (iii) The executive has to spend only in the manner sanctioned by parliament. This control is exercised by the comptroller and auditor-general (and, after the separation of Accounts from Audit, by the auditor-general).

India follows four principles of financial control:

- (i) the executive acting through ministers cannot raise money by taxation, borrowing or otherwise without the authority of parliament; and proposals for expenditure requiring additional funds must emanate from the cabinet.
- (ii) The second principle vests in the Lok Sabha the exclusive control of the purse. Money bills must originate in the Lok Sabha which has the sole power to grant money by way of taxes or loans and to authorize expenditure. The Rajya Sabha may reject a grant but not add to it.
- (iii) The demand for grants must come from the government. Neither the Lok Sabha nor a state Assembly may vote a grant except on demand for grant from the government.
- (iv) Similarly, the proposal for a new tax or for an increase in the rate of an existing tax must come from the government.

Annual Financial Statement shows the sums charged on the Consolidated Fund of India and the money required to meet other expenditures. The former is non-votable and the later is votable. Votable estimates are submitted to the Lok Sabha which can assent to, refuse, or reduce the grant but not enhance it. The Ministry of Finance administers the finances of the government; in fact, the entire structure of financial administration revolves round Finance Ministry. It frames the Annual Financial Statement in

consultation with the other ministries. After parliament has approved of the budget, it controls the entire expenditure of the government and a view to economy in public spending by the other administrative ministries. After the money has been spent, public expenditure is subjected to the searchlight of an independent audit to examine the legality and the propriety of the expenditure. Parliamentary control the taxation and expenditure is rendered effective through independent audit. The Auditor-General is independent of the executive and is accountable only to parliament. After parliament has voted grants to government, the auditor-general has to see that the money voted are spent does not exceed the amount granted. He has to report the parliament any expenditure not in conformity with the declared intentions of parliament or any faulty administration of a grant. The budget has three stages: preparation, legislation and execution.

The centre and the states in India have each its Consolidated Fund to which all receipts are credited and all authorized payments are debited. Expenditure is of two kinds: votable and nonvotable. The non-votable items, i.e., those that are charged to the Consolidated Fund are: (i) salaries and allowances of the president and expenditure on his office; (ii) the salaries of the chairman and then deputy chairman of the Rajya Sabha and the speaker and the deputy speaker of the Lok Sabha; (iii) debt charges including interest and amortization charges on government loans; (iv) salaries and allowance of the judges of the Supreme Court; (v) salary, allowances and pensions payable to or in respect to the Comptroller and auditor-general of India; (vi) any sums required to satisfy any judgement-decre of any court or arbitrary tribunal; (vii) any other expenditure declared by the Constitution or by parliament to be so charged. Expenditure on the counterparts of the above in the states are charged on the Consolidated Fund of each states.

The Committee on Estimates is a continuous 'Economy Committee' to suggest economics within the limits of accepted policy. It is not concerned with government policy as such. Its concern is with exploring how that policy could be achieved with minimum public resources. It has 30 members from the Lok Sabha elected on the principle of proportional representation by means of single transferable vote. Its chairman is appointed by the speaker. By convention one-third retires every year. It works throuah sub committees.

Apart from the Annual Financial Statement and the Demands for Grants, the following documents are also presented to Parliament as part of the overall budget:

1. **'Economic Survey'** : This gives a background to the economic trends prevailing in the country. It also gives an analysis of the agricultural and industrial production, money supply, imports and exports and other relevant factors which have a bearing on the framing of the budget so that the Parliament may have a better appreciation of the efforts made by the Government for mobilising resources and their allocation in terms of development priorities.
2. **'Public Enterprises Survey'** : This contains a detailed report on the operations of commercial public enterprises. Besides, the reports of the Comptroller and Auditor General of India on the operation of various public sector enterprises are also presented to Parliament during the budget session.
3. **'Expenditure Budgets'**: This gives not only the estimates in terms of revenue and capital under Plan and Non-plan heads in relation to each administrative unit, but also a description of expenditure in terms of major programmes. These are distinct from and in addition to 'Demands for Grants'.
4. **'Receipts Budget'** : Estimates of receipts included in the Annual Financial Statement are further analysed in this document. The document also gives details of revenue and capital receipts, the trend of receipts over the years and, more importantly the details of external assistance received by the Government.
5. **'Performance Budgets'** : These budgets are prepared by all ministries dealing with development activities. Also provided are separate appraisal reports in respect of certain major Central Sector Projects/ Programmes. A statement is included on the programmes and performances of each public sector undertaking under the respective administrative ministry, indicating the installed and utilised capacity, physical targets and achievements, results of operations, and return on capital.
6. **'Budget at a Glance'**: This document provides information regarding the total expenditure and resources, both for meeting Plan Outlays as well as under the scheme of devolution of financial resources envisaged in the Constitution, transferred from Union budget to the budgets of State Governments.
7. **Following the budget speech of the Finance Minister** (which is also printed in two volumes and placed before the Parliament along with

the budget documents), a Finance Bill is introduced incorporating the fiscal proposals of the Government for the levy of new taxes, modification of the existing tax structure or continuance of the existing tax structure beyond a period approved by the Parliament.

8. **To facilitate understanding of the taxation** proposals contained in the Finance Bill, the provisions of the Bills are explained in simple language in a separate document called 'Memorandum Explaining the Provisions of the Finance Bill'.

After the appropriation Act is passed, the grants as voted by parliament are distributed, care being taken to spread the cuts, of any, over numerous heads. Appropriation is the allocation of funds to a given units as passed by parliament. Within a grant, an intra-unit transfer of funds is permissible. Unspent balance, if any lapses. Actual expenditure deepens on two conditions: sanction by competent authority and provision of adequate funds. The spending authority shall exercise due care in the spending of public money. Public money shall not be spent for the benefit of a particular individual or community; and all orders sanctioning expenditure shall be communicated to the auditor. The accountant-general monitors the progress of receipts and expenditure and brings irregularities, if any, to the notice of the competent authority.

Four organs of government exercise financial control in a parliamentary democracy-the legislature, the government, the finance ministry and the audit department. Parliament exercises finance ministry and the audit department. Parliament exercises control over revenue, expenditure, borrowing and accounts. Legislative sanction is required for the levy of new taxes, for the withdrawal of money from the Consolidated Fund or for public expenditure, and for the raising of loans. Public accounts are scrutinized by the Public Accounts Committee and are audited by a statutory authority which is independent of the executive. India follows four principles of financial control: (i) the executive acting through ministers cannot raise money by taxation, borrowing or otherwise without the authority of parliament; and proposals for expenditure requiring additional funds must emanate from the cabinet, (ii) The second principle vests in the Lok Sabha the exclusive control of the purse. Money bills must originate in the Lok Sabha which has the sole power to grant money by way of taxes or loans and to authorize expenditure. The Rajya Sabha may reject a grant but not add to it. (iii) The demand for grants

must come from the government. Neither the Lok Sabha nor a state Assembly may vote a grant except on demand for grant from the government. (iv) Likewise, the proposal for a new tax or for an increase in the rate of an existing tax must come from the government.

The Committee on Estimates is a continuous 'Economy Committee' to suggest economics within the limits of accepted policy. It is not concerned with government policy as such. Its concern is with exploring how that policy could be achieved with minimum public resources. It has 30 members from the Lok Sabha elected on the principle of proportional representation by means of single transferable vote. Its chairman is appointed by the speaker. By convention one-third retires every year. It works through sub committees.

1.2 □ Public Accounts Committee

An effective control over public expenditure is essential for the success of a financial administration in a democratic country. The parliament is incapable of undertaking this task due to its large size. It has neither the time nor the capacity for performing controlling functions. Therefore, parliament exercises effective control over the finance of the country through its two committees, viz. Committee on public Accounts and the Committee on Estimates.

It is meaningless to vest the legislature with the power of voting for particular purpose unless it is empowered to investigate that the money is spent by the administration for the very purpose for which it was voted. A system of continuous audit of public accounts by an independent authority is adopted for this purpose. The report of such an auditor is made to a committee of the Legislature popularly called public Accounts Committee for further examination and a report of its finding to the legislature. Under the Act of 1919 the Public Accounts Committee was first committee in the Governor General's executive. It was not possible for the members of the committee to freely discuss the government activities. With the inauguration of the new Constitution, the government members have been removed from the committee. In the beginning there were 15 members, all taken from the House of people. From 1953 the membership of the Committee has been raised to 22 of which 7 members represent the Council of States.

The Committee is composed for a financial year by both the Houses jointly electing members on the basis of single transferable vote of

proportional representation. All political parties share the representation on the basis of their numerical strength. Unlike U.K. where the Chairman is from the opposition and there is no member from the House of Lords, in India the Chairman of the Committee is from the ruling party.

Functions of PAC

As embodied in the Rules of Procedure of Business the functions of the committee are to satisfy:

That all monies, shown in the accounts as having been disbursed, were legally available to the activity or purpose to which they have been charged,

That the expenditure to the authority which governs it, and

That every re-appropriation has been made in accordance with the provision made in this behalf under rules framed by competent authority.

The Public Accounts Committee shall also perform the following functions

1. To examine, in the light of the report of the Comptroller and Auditor General, the statement of accounts showing the incomes and expenditure of State Corporations (i. e, Air Corporation, Damodar Valley Corporation), trading and manufacturing schemes, projects etc. together with the balance-sheet and statements of profit and loss account.
2. To examine the statement of accounts showing the income and expenditure of autonomous bodies, the audit of which may be conducted by the Comptroller and Auditor General of India.
3. To consider the report of the Comptroller and Auditor General in cases where the president may have required him to conduct an audit of any receipts, to examine the accounts of stores and stocks.

For the successful discharge of its functions, the PAC is empowered to send for persons, paper and record. It is authorized to put question to the concerning officials regarding the expenditure recorded in the accounts under its consideration.

The main work of the Committee is to examine the report of the Comptroller and Auditor General, in order to ascertain that the money granted by then Parliament has been legally spent by the Government within the scope of the demand. After the scrutiny of witnesses and documents and Committee prepares its report to submit to the Parliament. The recommendations of the Committee are invariably accepted and implemented by the Government. If the Government and the Committee do not agree on

the recommendations, the matter is eventually placed before Parliament, though such occasion seldom arises.

The general criticism against the Committee is that its work is only a postmortem. It serves no purpose, as once money has been wrongly spent, it cannot be recalled. But even the postmortem has its own utility. In the words of Mr. G.V. Mavlankar, "The very fact of consciousness that there is someone who will scrutinize what has been done, is a great check on the slackness or negligence of the executive. The examination, if it is properly carried out, thus leads to general efficiency of the administration. The examination by the Committee may also be useful as a guide for both future estimates and future policies.

1. Expert Control. The Committee's control is an expert control. It makes full use of an expert audit whose aims are harmonized with its own. This is primarily a financial control to check an audit. It has nothing to do with the investigation of current expenditure.
2. Judicial Control. The law is clear. The past actions of the Department are clear and members have to decide whether the law and the past action of the department are in conformity.
3. Non-partisan Control. It has been described by Austin Chamberlain as a committee of judges putting aside for the time all party consideration.
4. Role in the Indian Financial Administration. From time to time the committee has successfully pointed out the financial irregularities of the government. For example, in 1947-49 the Committee drew attention of the Parliament towards the waste of 1.5 crores of Rupees over Sarnath Railway line. The committee has given many invaluable suggestions for the reform of the financial administration of the country.

1.3 □ Other Parliamentary Committees

Though Parliament itself does not govern the country, it exercises supervision over executive action in various ways through the purposive use of parliamentary procedures and a system of committees, although there is no constitutional provision for such committees of Parliament. As mentioned earlier, Parliament has set up three financial committees, viz. Public Accounts Committee (PAC), Committee on Public Undertakings (COPU) and the Estimates Committee, to assist effective parliamentary control over public finance.

The PAC examines the accounts showing the appropriation of sums granted by the House for the expenditure of the Government of India, the annual finance accounts of the Government and such other accounts laid before the House as the Committee may think fit. Since 1962-63 the Committee has also examined the revenue receipts.

In scrutinizing the Appropriation Accounts of the Government of India and the Report of the Comptroller and Auditor General thereon, it is the duty of the Committee to satisfy itself that :

- a. the moneys shown in the accounts as having been disbursed were legally available for, and applicable to, the service or purpose to which they have been applied or charged;
- b. expenditure conforms to the authority which governs it; and
- c. every reappropriation has been made in accordance with the provisions made in this regard under rules established by competent authority.

Even though the Parliament discusses the budget estimates for a sufficiently long period, there is often neither the time nor the flexibility to discuss the details and the technical aspects of the estimates. The Estimates Committee was therefore constituted to examine the estimates. The functions of this committee are detailed in Section 5.1 of this chapter.

Thirdly, COPU examines the reports and accounts of the public undertakings, including the audit reports of the CAG thereon. It is the function of this Committee to see whether the affairs of the public undertaking are being managed in accordance with sound business principles and prudent commercial practices.

The reports of the various committees are presented to the Parliament. The Government is required to inform the PAC/COPU within six months of the action taken by it on the recommendations of the committees. The committees, in turn, consider the Government's replies and present their further report known as the 'Action Taken Reports' incorporating their views on the action taken by the Government.

An adhoc committee, known as the Railway Convention Committee, is also constituted to review the rate of dividend which is payable by the railway undertaking to the general revenues in addition to other ancillary matters in connection with railway finances vis-a-vis general finances, and make recommendations thereon.

Subject Committees

Other parliamentary subject committees have been established recently for the specialised examination of government activities in such fields as agriculture, environment and forest, and science and technology. Although these specialised committees and the Estimates Committee may utilise the information contained in the various audit reports of the CAG, so far there has been no established convention of the CAG assisting them in their examination and reporting activities.

Other Agencies

The Department of Public Enterprises of the Government of India analyses and monitors the annual performance of each public enterprise within the jurisdiction of COPU and submits to the government and parliament a combined annual performance appraisal of the public enterprises.

The Planning Commission undertakes selective monitoring covering major projects/programmes and important sectors. It also reviews the progress of the plan each year mainly in financial and some times in physical terms based on the detailed information obtained from central ministries and state governments during the formulation of the annual plan for the next year. The results of this review are given in the annual plan document. In addition the Commission brings out the mid term review of the Five Year Plans.

1.4 □ Estimates Committee

While the Public accounts committee examines the expenditures of the public funds it has no authority over the appropriations of money. To fulfill this purpose another Committee called Estimates Committee exercises financial control on behalf of the Parliament.

In addition to the financial surveillance of the Public Accounts Committee and the Committee on Public Undertakings, the Estimates Committee examines the estimates of the Governments to determine the financial propriety of planned revenues and expenditures, subject to policy constraints. The Estimates Committee subsequently reports on any economies, improvements in systems, or reforms, which may be effected. Where necessary, alternative policies to achieve increased efficiency and economy in administration are suggested. It is also one of the functions of this Committee to recommend the form in which the budget estimates are to be presented to Parliament.

Functions of the Estimates Committee

1. To report what economics, improvements in organization, efficiency or administrative reform, consistent with the policies underlying the estimate may be effected.
2. To suggest alternative policies in order to bring about efficiency and economy in administration.
3. To examine whether money is well laid within the limit of policy employed in the estimates.
4. To suggest the form in which estimates can be presented to the Parliament.

Estimates Committee can appoint one or more sub-committees each having the same power as those of Principle Committee, to examine any matter that may be referred to them. The report of such subcommittee is deemed to be the report of the whole Committee provided the whole Committee approves them. The Committee has powers to call for the officials and to examine their evidence connected with the estimates under examination. It sends a prepared questionnaire to the departmental heads for answer. It can ask them for any charts, figures etc. from the department.

Reports are in the form of recommendations to the Government. The Government has either to accept or reject its recommendations. But it has to give reasons for not accepting them. When the Committee insists on its earlier recommendations the ultimate decision must rest with the Parliament. As differences are resolved by the process of consultations, such a situation is never allowed to arise. The very Estimates Committee of the Parliament presented more than 40 reports. Of these recommendations, the second was relating to the reorganizations of Government departments and the Central Secretariat; the fourth was about River Valley Project, the ninth dealt with the administrative, financial reforms. In its 20th report (1957-58) the second Committee opined that budget year must begin from October 1 instead of 1st April.

The Committee in its reports gives three types of recommendations

1. Concerning Reforms in Administrative Organization.
2. Relating to the Reforms in Financial Administration.
3. Regarding reforms in the system of presentation of budget estimates.

1.5 □ Other Financial Committee

The Finance Ministry of the Government of India is responsible for financial administration of Central Government. It exercises great control

over items of expenditure pertaining to estimates which have been approved by the Parliament, and for which resources have been duly appropriated. It controls and coordinates all other executive departments. It frames general financial and economic policies and programmes of the Government of India. It prepares estimates of income and expenditures and submits them for approval before the parliament. After the approval of the Parliament, the Finance Ministry plays an important role in the execution of the budget.

The Chairman of the Finance Ministry is a senior Cabinet Minister called Finance Minister. There are a Minister of State and two Deputy Minister to assist the Minister Incharge. This ministry was originated in 1810 as Finance Department. In 1947 it was divided into three divisions: each headed by an I.A.S. Secretary, 1. Department of Economic Affairs, 2. Revenue Department, 3. Expenditure Department.

1. Department of Economic Affairs - This Department keeps an observation on the present economic tendencies of the country. It advises the Government all matter, affecting internal and external financial management. It is divided into the following seven divisions:

- A. Economic Division
- B. Banking Division
- C. Insurance Division
- D. Budget Division
- E. Investment Division
- F. External Finance Division
- G. Currency and Coinage Division.

The various divisions of the Department are concerned with consolidation and preparation of Central Budget: review of State Budget, Banking, Currency, Public Debts, Capital Issues, Foreign Exchange etc. Assisted by many economic experts the Chief Economic Adviser of the Department performs the following functions.

- a. To carry on research on important economic financial monetary problems of the country.
- b. To prepare and maintain the statistics relating to balance of payments, trade, currency and coinage.
- c. To study and analyze foreign economic financial reports.

2. Revenue Department - Besides being a Revenue Department, it also functions as a Central Board of Revenue. It deals with the following subjects.

- a. As a Revenue Department it advises Government on the financial policy matters, and
- b. As a board of Revenue it enforces the fiscal policy of the Government.

3. Expenditure Department - It deals with the administration of the following subjects:

- a. Financial Corporation - Control and delegation of financial powers.
- b. Financial sanction to all ministries and department, who do not have special sanction.
- c. To bring economy -Reconsideration on fresh appointment in the Government establishment.
- d. To advise ministers and public enterprise on all questions concerning cost accountancy.
- e. Plan Finance Division-I
- f. Plan Finance Division-II
- g. Comptroller General of Accounts.

The Expenditure Department is divided into seven Divisions :

- (i) Establishment Division
- (ii) Finance Commission Division
- (iii) Cost Accountant Branch
- (iv) Staff Inspection Unit.
- (v) Plan Finance Division-I.
- (vi) Plan Finance Division-II
- (vii) Comptroller General of Accounts.

- 1. Establishment Division :** It is responsible for the administration of financial rules and regulations, delegation of financial powers to ministries, departments etc., financial scrutiny of proposals relating to conditions of service, i.e. pay, pension, leave and deputation of Government servants.
- 2. Plan Finance Division-I.** It is the central point in the Ministry of Finance to estimate total budget resources and extra budget resources for the central as well as state plans.
- 3. Plan Finance Division-II.** It settles all matters concerning the central plan. It also works as the secretariat of Public Investment Board.

4. **Finance Commission Division.** Recently, this Division has been placed under the Expenditure Department to come out following:
 - a. To keep an eye on the implementation of the recommendation of Finance Commission.
 - b. To study the state finance and to publish such research papers and data which relate to the state finance. This division presented an analysis of the interim report of the 5th Finance Commission.
5. **Cost Account Branch.** It is an independent body for the fixation of prices in the market. As an expert of Cost Accounts and managerial accounts, the division provides professional assistance to different ministries, committees, industrial cost and price departments.
6. **Comptroller General of Account.** Established in 1976 it is the highest policy making institution in the Ministry of Finance. To exercise the powers of the President, under Article 150, this institution determines the forms of Central State Account to be maintained.
7. **Staff Inspection Unit.** It was established in 1967, to bring about administrative uniformity in the Government offices based on Government grants. It also suggests the ways and means to bring about economy in the number of personnel, and to prepare standard of work.

Module-IV ● Unit 2 □ Centre State Financial Relations in India

Structure

- 2.1 Introduction
- 2.2 The Union Sources
- 2.3 The States Sources
- 2.4 Concurrent Sources
- 2.1 Finance Commission

2.1 □ Introduction

In India, the source of revenue has been divided in the following ways. The three lists of power given in the Seventh Schedule of the Constitution, divide the sources of revenue between the Union and the States as follows

2.2 □ The Union Sources:

- 1) Taxes on income other than agricultural income
- 2) Customs duties including export duties.
- 3) Duties of excise on tobaccos and other goods manufactured or procured in India except
 - (a) alcoholic liquors for consumption, and
 - (b) opium, Indian hemp, and other narcotic drugs and narcotics.
- 4) Corporate tax
- 5) Taxes on capital value of assets, exclusive of agricultural land, of individuals and companies taxes on capital of companies.
- 6) Estate duty in respect of property except agricultural land
- 7) Duties in respect of succession to property except agricultural land.
- 6) Terminal taxes in goods or passengers carried by railways, sea or air; taxes on railway fares and freights.
- 9) Taxes other than stamp duties on transaction in stock exchanges and future markets.
- 10) Rates of stamp duty in respect of bills of exchange, cheques, promissory notes, bills of lading, letters of credit, insurance policies, transfer of shares, debentures, proxies and receipts.

- 11) Taxes in sale or purchase of newspapers and advertisements published therein
- 12) Fees in respect of any of the matters in the Union List except fees taken in any court.

Three other sources of revenue for the Union Government may be mentioned.

1. Income from the business enterprise and government monopolies, e.g. railways, posts and telegraphs, salt manufacture, cultivation and manufacture of opium, etc.
2. Income arising from the sovereign rights and functions of the States, e.g., income from the sovereign rights and functions of States, the income on property accruing from lapse or escheat, etc.,
3. Sums raised by the government.

2.3 □ The States Sources :

1. Land revenue.
2. Taxed on agricultural income.
3. Duties on succession to agricultural land.
4. Estate duty in respect of agricultural land.
5. Taxes on land and buildings.
6. Taxes on mineral rights subject to limitations imposed by law.
7. Excise duties on alcoholic liquors human consumption, and opium, hemp, and other narcotics drugs.
8. Taxes on the entry of goods into a local area for consumption, use, or sale therein.
9. Taxes on the sale or purchase of goods other than newspaper.
10. Taxes on consumption on sale of electricity.
11. Taxes on advertisement other than those published by newspapers
12. Taxes on goods carried by road or inland waterways.
13. Taxes on vehicles for use on roads.
14. Taxes on animals and boats.
15. Tolls
16. Taxes on professions, trades, callings, and betting and employments.
17. Capitalization taxes.
18. Taxes on luxuries, entertainment, betting and gambling.
19. Rates on stamp duty on documents other than those subject to Union stamp duty.

20. Fees in respect of any of the matters in the State list. Other Sources

There are four other sources of income for the States.

1. Business enterprise likes transport, fisheries, etc.
2. Royalty from mines, forest revenue, treasure trove, etc.
3. Grant in aid from the Union Government
4. Borrowings

2.4. ☐ Concurrent Sources:

1. Stamp duties other than those collected by means of judicial stamps but excluding rates on stamp, and
2. Fees in respect of any of the matters in concurrent sources for the Union and the States.

Thus the heads of taxes and the powers of the Union and the States with respect to raising money by taxes are set in the Indian Constitution. From the point of view of the actual allocation of their proceeds, the Union sources of taxes fall into five categories.

1. There are taxes which are levied and 'collected by the Union and their proceeds also go entirely to the Union. All the taxes mentioned in the Union List belong to this class, except those about which some other specific provision is made in the Constitution.
2. There are taxes that are levied by the Central Government but are collected, by, assigned wholly to the States. Stamp duties and excise duties on medicinal and toilet preparations, as mentioned in the Union List, fall in this category.
3. There are taxes and duties which are levied and collected by the Union but the net proceeds of which are assigned to the States. These include
 - a. Duties in respect of succession to property other than agricultural land,
 - b. Estate duty in respect of property other than agricultural land,
 - c. Terminal taxes on goods or passengers carried by railways, sea or air,
 - d. Taxes on railways fares and freights,
 - e. Taxes other than stamp duties on transaction in stock exchanges and future markets: and
 - f. Taxes on the sale or purchase of newspaper and on the advertisement published in them.

4. Taxes on income other than agricultural income shall be levied and collected by the Government of India and distributed between the Union and the States. Income tax is levied and collected by the Union Government, but its proceeds are distributed between the Union and the States.
5. There are surcharges (i.e. increased rate) which the Union Government can levy on any of the taxes and the duties mentioned in Articles 269 and 270. Even though the taxes subject to such surcharge are assigned or shared with the States, the proceeds of the surcharges go wholly to the Union.
6. There is also a provision for grant-in-aid from the Union to the States. States can also ask for loans from the Centre or they can borrow from the open market.

2.5 ☐ Finance Commission

Article 280 (1) - The President shall within two years from the commencement of this Constitution and thereafter at the expiration of every fifth year or at such earlier time as the President considers necessary, by order constitute a Finance Commission which shall consist of a Chairman and four other members to be appointed by the President.

The Finance Commission is "a quasi-arbitration body whose function is to do justice between the Centre and the States". It has also been described as "the most important body to regulate, coordinate and integrate and finances of the Government of India and the State Government". The Indian Constitution provides for the appointment of a Finance Commission for making proper financial adjustment between the Centre and the State Governments. It shall be the duty of the Commission to make recommendations to the President as to :

- a) the distribution between the Union and the states of the net proceeds of taxes which are to be or may be, divided between them under this chapter (distribution of revenues between the Union and the States) and the allocation between the states of respective shares of such proceeds.
- b) the principles which should govern the grant-in-aids of the revenues of the States out of the Consolidated Fund of India;
- c) the continuance modification of the terms of any agreement entered into by the Government of India with the Government of state specified in

Part B of the First Schedule under the clause (1) of Article 278 or under Article 306; and any other matter referred to the Commission by the President by the President in the interest of sound finance."

The Finance Commission is an advisory body whose recommendations may not be accepted. Political commitments or obligation arising out of the norms of parliamentary democracy, fear of opposition within and outside the parliament, vigilance of public opinion work as a strong force.

According to these provisions of the Constitution, the First Finance Commission was appointed by the President on November 30, 1951 and it submitted its report on December 31, 1952. Shri Neogi was its chairperson. The First Finance Commission laid down the principles of revenue distribution. It propounded three principles concerning the Centre-state Revenue distribution. These principles are:

- a) The additional transfer of resources from the Centre must be such as the Centre could bear without undue strain on its resource, taking into account the responsibility for such vital matters as the defense of the country and the stability of its economy.
- b) The principles for the distribution of grant-in-aid must be uniformly applied to all A and B States (since the reorganization of the States, the distinction between A and B has ended.)
- 3) The scheme of distribution should attempt to lessen the inequities between the States. The Finance Commission observed, "The prosperity of the States must rest on the solid foundation of a reasonably strong and financially stable Centre". The Commission recommended that the percentage of the net proceeds of income tax to be allocated to the States be raised from 50 per cent to 55 per cent. The Second Finance Commission has raised it from 55 percent to 60 percent. As between the various States, the First Finance Commission proposed that 20 per cent of the income-tax proceeds should be divided on the basis of relative collections of tax and 80 % on the basis of relative population according to the census of 1951.

The basic approach in the recommendation of the Commission has been that 'the prosperity of the States must rest on the solid foundation of a reasonably strong and financially successive Finance Centre'. The net result of the recommendation of the successive Finance Commission has been a progressive increase in the amount of Union grants to the State under Article 275 of the Constitution.

Under the circumstances, the division of financial source between the Centre and the States in India is quite satisfactory. Income tax is the largest single source of income. It is judiciously shared by both the Central and the State Governments as per the recommendations of the Finance Commission. The provision of review of financial sources by a Finance Commission is a favorable feature of the Indian federal system, if not politicised.

Module IV ● Unit 3 □ Planning and Financial Administration

Structure

- 3.1 Introduction
- 3.2 Planning Commission
- 3.3 The National Development Council (NDC)
- 3.4 Referemces

3.1 □ Introduction

The Government of India has constituted a body known as the Planning Commission with the Prime Minister as its Chairman and members comprising eminent personalities from the various fields of economics, agriculture, education, industry, social sciences and public administration. Socio-economic development planning attempted by the Commission covers the entire country including the States. Nationwide coordination is obtained through the National Development Council represented by the Chief Ministers of all the States. The planning process takes into account.

- (i) the required growth rate of the Gross Domestic Product (GDP),
- (ii) the growth rates for various sectors of economy,
- (iii) the sources of funding, and
- (iv) the methodology of achieving the planned goals.

The Planning Commission also examines and gives its expert advice on various projects and programmes.

The five year plans are formulated and are then de-segregated into annual plans. The annual plans are then prepared in respect of each sector. These are further demarcated between the Union Government and States. Thereafter, the process of entrustment to various ministries and departments takes place. The orientation of the budgets in India is largely determined by plan outlays, their composition and sources of funding. 1. Planning Machinery - In India, the responsibility of plan formulation lies with the Planning Commission. It consists of four steps :

- a. Preparation of Draft Plan: - The preparation of the draft plan is done in consultation with Central Ministries and State Government by the Planning Commission. The available resources are assessed and priorities are determined. Thereafter the draft is submitted to the

National Development Council, which after a long deliberation forwards the draft to the Central as well as State ministries with proposed modification.

- b. Self-preparation of Plans : - All Central as well as State Ministries prepare their own plan. At State level there are planning boards or planning departments. At State headquarters there are Interdepartmental Committees to coordinate departmental plans. Consisting of secretaries of different development departments. Its chairman is either the chief secretary or the secretary for planning. Besides, there is a separate committee, which formulates policies. In all districts there are district planning committees which bring about co-ordination among the proposals of village panchayat plans. The State Planning Committee takes the final decision.
- c. Comprehensive Draft of National Plan: -When all proposals of plans have been set to the Planning Commission by different Central and State Ministries, it prepares a comprehensive plan from the separate proposal. While finalizing the plan, the different political parties are invited for consultation. At last the proposed draft for the plan is published. The public opinion on the plan is assessed. Non-official economists, university professors, political parties, press, chambers of Commerce etc. freely express their views on the plan.
- d. Approval of Parliament: -After the public opinion on the plan finally formed and known to the country, negotiations go on between the Centre and the States. When they come to an agreement, then plan outlay is presented before the Cabinet for consideration and approval. After the Cabinet approval, the plan goes to the National Development Council. With its recommendations, it again comes to the Planning Commission for giving it a final shape and submission to the parliament. After the Parliament's approval it is published as a government plan.
2. Plan Implementation. Plan implementation is the responsibility of the Central Ministries and State Government to execute the plan. The administrative departments of the Government undertake this responsibility.

There are following shortcomings in the process of implementation.

1. Slow speed of implementation.
2. Undue waste of money

3. Lack of trained personnel
4. Lack of coordination between Central and State Government
5. Lack of proper support
6. Lack of coordination between different economic fields

For successful and effective planning the removal of the above defects is essential.

3. Plan Evaluation. The plan evaluation is made through the following agencies:
 - a. By Annual Reports of the Central and State Governments.
 - b. By Programme Advisers.
 - c. Committee on Plan Projects (COPP).
 - d. Programme Evaluation Committee.
Programme Evaluation Organization.

Programme Advisers. In 1952, three posts of Programme Advisers were created, and the fourth was added thereafter. Senior administrative officials are appointed on their posts who tour different States and hold consultation and provide guidance to the State planning officers.

Committee on Plan Project (COPP). It was formed in December 1956. Home Minister is its Chairman and Finance Minister vice Chairman. Its main functions are:

- a) Investigation of specific plan projects of the Central and State Government by specially appointed specialists.
- b) To advise the proper methods for the successful implementation of the projects.
- c) To provide suggestions to bring economy in projects.

Programme Evaluation Organization. In October 1952, it was established as an autonomous body to look after Community Development Programmes. It keeps a close touch with Ministries of Agriculture and Community Development. It consists of a Director, two Deputy Directors, eight Research Officers and other personnel. Its duties are as follows:

- a) To evaluate the achievements of Community Development programmes.
- b) To provide information of the progress regarding achievement of aims of programmes.
- c) To indicate the effective and ineffective methods of extension.
- d) To disclose who approved methods were accepted or rejected by the village people.

- c) To explain the impact of the Community Development Programme on the Indian economy and culture.

3.2 □ Planning Commission

The Planning Commission was constituted by a resolution of the Government of India on 15th March 1950. The Commission with the Prime Minister as the Chairman has emerged as the authoritative organization devoting its attention to the whole field of development. The Planning Commission consists of the Chairman, the Deputy Chairman and another members, whose number has never remains fixed. The Deputy Chairman devotes whole time attention to the Commission's work. The Ministers of State for Planning and Programme Implementation is a member of the Commission and serves as a link between the Government and Parliament. The Finance Minister is invariably a member of the Commission.

- The Planning Commission works through three major divisions- Programme Advisers, General Secretariat and Technical Divisions. The Planning Commission performs the following functions :

Makes an assessment of the material, capital, and humane sources of the country including technical personnel and investigates the possibilities of augmenting such of these resources as are found to be deficient in relation to the nation's requirements.

- Formulates a Plan for the most effective and balanced utilization of the country's resources.
- Determines priorities, from the implementation point of view, as between projects and programmes accepted in the Plan.
- Indicates the factors which are tending to retard economic development and determines the conditions which should be established for the successful execution of the Plan.
- Determines the nature of the administrative machinery, which will be necessary for securing the implementation of each stage of the Plan in all its aspects.
- Appraises from time to time the progress achieved in the execution of each stage of the Plan and recommends the adjustments of policy and measures that such appraisal may show to be necessary,
- Makes recommendations either for facilitating the discharge of its duties or for considerations of the prevailing economic conditions, current

policies, measures and development programmes or for an examination of problems referred to it for advice by central or state governments.

The Commission is not a constitution of the Prime Minister and other important Union Ministers. It was expected to be a compact, technical body to work out the country's national planning and monitor results on the ground. In course of time, however, the Commission has grown into big bureaucracy, sometimes assigning the role of overlordship over the ministries and the departments. The Administrative Reforms Commission characterized the Planning Commission as a "super cabinet" thus complicating and adding to the levels of decision-making in the Government of India. The other criticism has been that when the Ministers are made members of the Commission, this takes a heavy toll of the Commission's independent functioning. The Commission's approach and analyses of the economy need to be autonomously developed; at least that was the original purpose of this august body.

The real danger now is posed by the liberalization-globalization policy adopted by the government. There are pressures from international funding agencies that more and more space should be left for the market 'market forces' to operate and the government should withdraw from many areas of operation and leave the private sector to take over many of the operations and leave the private sector to take many of the government activities of today. Although there is understandable reluctance to allow free play to the market forces because of widespread poverty and imperfection of the market, there is already a feeling emerging that the days of comprehensive economic planning are over. Today the need of the hour is to reorient planning to develop the economy from the view of both productivity and social justice, and at the same time the internationalization of the economy needs to be acknowledged. Planning nowadays is not only essential for Indian economics but must begin by keeping the process of 'liberalization' in balance. A far more imaginative strategy has to be evolved for coming to terms with the international economy and yet retaining the autonomy of decision making. Some of the elements of this strategy must be the following:

- * radical land distribution,
- * free and compulsory primary education and
- * the provision of adequate health care for all,
- * the provision of basic amenities in rural areas decentralization of decision-making and resources, an export thrust through an appropriate industrial policy,

- * a step- up in the investment ratio with public investment, especially in infrastructure and based on domestic resource mobilization, playing the leading role, and
- * the putting into place of appropriate controls to ensure that 'enterprise' does not become 'the bubble on a whirlpool of speculation'.

Obviously, the Planning Commission has to reorganize itself to face up to these new challenges today.

3.3 □ The National development council (NDC)

The NDC is the unique planning organization, representing the federal constitution of the country and symbolizing national consensus of the vital field of planning and development of the nation and its constituent units. From the very beginning, it was felt that in a vast country like ours where the states enjoy a degree of autonomy, there would be need for a coordinating body at the top of the planning pyramid. It was recognized that both at the beginning of the planning process and in course of plan implementation and evaluation would be as much technical as political.

Accordingly, the NDC was set up in August 1952 under the proposal of the Cabinet Secretariat of the Government of India. Since its inception, the NDC has consisted of top-level representatives of the central as well as state governments along with the member of the Planning Commission. The Administrative Reforms Commission in 1967 reviewed the organization of the NDC. The recommendations of the ARC were accepted with some modifications. As reconstituted in October 1967, the NDC consists of the following members:

- The Prime Minister
- All Union Cabinet Ministers
- Chief Ministers of States
- Chief Ministers/Chief Executives of the Union Territories
- Member of the Planning Commission

The NDC maintains detailed record of its discussions and functions, and takes decision on the basis of consensus. The main functions of the NDC are as follows :

- To provide guidelines for the formulation of the national plan;

- To consider the national plan as formulated by the Planning Commission.
- To assess resources needed for plan implementation.
- To consider major issues relating to social and economic development policy;
- To review the working of the plan from time to time and to recommend appropriate measures for achieving the aims and targets as set in the national plan.

The NDC has evolved over the years a practice of consensual planning. There have been debates and discussion, points and counterpoints and clashes and conflicts over the objectives and processes of nktirming. But it is this forum that has facilitated both surfacing of differences and their cementing in /order that a national consensus could emerge on planning. The states Chief Ministers have used this forum to ventilate their grievances and points of view. Thus, the NDC has been able to federalize the planning process.

Critics, however, point out that the NDC does not have the time or expertise to go deep into the intricacies of the planning process. At best, the NDC has been able to iron out major differences over the size of the plan, its main thrust, and distribution of plan fund among the states. Considering the vastness of the country and the diversities and complexities involved in planning, the NDC's role in "nationalizing" and "federalizing" the planning process needs a thorough scrutiny.

Formulation of Plan - National Plan

Planning in India's federal context is both a top-down and a bottom-up process. The national plan exercise starts with the laying down of broad long-term objectives, say for 15 to 20 years. Within down of broad long-range vision, a five-year plan is formulated. A number of working groups is constituted consisting of experts, administrators, and members of the Planning Commission. These groups work out targets for different sectors such as agriculture, power, health etc. Views and suggestions of States and Union Territories are also obtained in due course.

An Approach Paper is prepared on the basis of the reports of the working groups. This placed before the NDC for review and approval. The next step is to prepare the draft five-year plan on the basis of the Approach Paper. The draft plan contains the plan objectives, resources assessment exercise, and indications about priorities and targets in different sectors.

Discussions take place on the draft plan in both government (central and state) and non-government circles. After ascertaining the responses of governments and other concerned parties, the final version of the plan is brought out with modifications in the light of the reactions and responses.

The five-year plan is formally endorsed by the Union Cabinet and then placed before Parliament for general approval.

Formulation of Plan - State and District Level

At the State level, plan is the result of interactions between the Planning Commission and the State. Within the state, the district planning attempts to decentralize the planning process at the sub-state level.

At the time of preparation of the Planning Commission's Approach Paper, the states send their suggestions from their points of views and requirements. Even before that, the states initiate advance action on plan formulation. Different departments of the state start working on their priorities and requirements for incorporation in the five years plan.

In preparing their own approach paper, the states keep the national approach paper in view; but at the state level, attention is focused more on the state's own specific needs, priorities and resource positions. The State Planning Board plays a crucial role in conducting negotiations and discussions with the different departments and agencies at the state level, including the Zilla parishads at the district level. It is through the coordinating and technical role of the State Planning Board that a draft state five year plan is formulated. This is taken up for discussions at the level of central working groups and the Planning Commission. The plan proposal the states are reviewed and approved by the Planning Commission, keeping in view the national and state priorities and resources.

With the passage of the 73rd and 74th constitutional Amendment Acts (1992), district planning and municipal and panchayat planning have become constitutional obligations. As the Amendment suggests, the planning process has now to start from the micro level-a gram panchayat or a municipality. These micro area plans are to be integrated at the level of the district planning. So, the district plan has to take into account both local plans and the state departmental plans at the district level. The draft district plan will then be forwarded to the State Planning Board for its integration with the overall plan of the state. This process of multi-level bottom-up planning has

just started, Preparations are going on and the ground is being made ready for institutional and financial changes in facilitation of micro-level planning. In the coming years, the planning process is going to be more participative and decentralized; and at the same time, because of popular pressures, more and more demands are likely to surface local-level planning more conflictual and complex and participative.

Module IV ● Unit 4 □ Local Level Planning

Structure

4.1 Introduction

4.2 References

4.3 Exercises

4.1 □ Introduction

Local Level has been made a constitutional obligation under Article 243ZD of the Constitution (Seventy Fourth Amendment) Act, 1992. To quote the constitutional provision:

"There shall be constituted in every state at the district level a District Planning Committee (DPC) to consolidate the plans prepared by the Panchayats and the Municipalities in the district and to prepare a draft development plan for the district as a whole".

The state legislature will have to make provision in respect of

- the composition of the District Planning Committee (DPC),
- the manner in which the seats in the DPC shall be filled,
- the functions that may be assigned to the DPC, and
- the manner in which the chairperson of a DPC shall be chosen.

The constitutional direction is quite clear. In every state, a DPC must be constituted for each district. The DPC will be mainly an elected body, as it has been provided that not less than four-fifth of the total number of members of the DPC shall be elected by, and from amongst, the elected members of the panchayats at the district level and of the municipalities in the district, in proportion to the ratio between the population of the rural areas and of the urban areas in the district.

In constituting the DPC, the Constitutional Amendment has taken care to see that

- the elective element predominates,
- the rural representatives are more numerous than urban representatives and
- a small percentage (one fifth) of membership may be filled by nomination.

As regards "functions" of the DPC, the Constitutional Amendment has specified both the procedure and the substantive contents. The procedural aspect has to be inferred from two expressions in Article 243ZD :

- To consolidate the plans prepared by the Panchayats and the Municipalities in the district, and
- To prepare a draft development plan for the district as a whole.

To consolidate means to unite or combine into one. A number of institutions will prepare the local area plans (a municipality in an urban area, and a specific tier of panchayati raj in a particular location). A gram panchayat will plan for its own area; a panchayat samiti will do planning for the samiti area; and a zilla parishad will plan for the entire district. Besides, municipalities and the panchayati raj institutions, there may be other organizations whose functioning will have important consequences for district planning. For instance, the cooperative institution plays important role in the provision of agricultural credit. Many government departments such as forest, agriculture, fisheries, irrigation etc. have their own development schemes in specific areas of the districts. In planning for the district as a whole, the DPC has to integrate these "plans" of different institutions and agencies. An overall unity of purpose has to be achieved through the district plan, and the DPC has to make sure that the institutions and agencies do not work at cross purposes.

What the DPC will prepare out of this exercise in "consolidation" is a "draft development plan". It is expected that the district plans prepared by different districts in a state will be integrated at the state level by the State Planning Board. There has to be a "vision" of planned development of the state as a whole. The state's vision will be influenced by the micro visions of local level planning. In fact, the two visions-macro and micro-need to be blended together.

The state will seek to issue directives to the local governments and the DPCs to ensure that the broader "vision" of the state and the local "visions" of individual units are suitably integrated and welded into a well-coordinated developmental outlook for the entire state. It is, therefore, logical that the DPCs major responsibility will be to "consolidate" the local plans and to "prepare a draft development plan" for the district as a whole. Article 243ZD (4) has clarified further the role of the DPC in the following manner: "Every District Planning Committee must take into notice the

- matters of common interest between the Panchayats and the

Municipalities including spatial planning, sharing of water and other physical and natural resources, the integrated development, of infrastructure and environmental conservation;

- the extent and type of available resources whether financial or otherwise: and
- consult such institutions and organizations as the Governor may, by order specify".

The implications of the constitutional provision are clear. The DPC has to make a distinction between particular interests and common interests of each local body. For instance, there may be local road or a local primary school, which will be the exclusive interest of a panchayat or a municipality. A trunk road cutting across local areas or a higher secondary school admitting students a number of panchayats and municipalities. Similarly, municipality and a panchayats may be drawing water from one single source, and there may be a common drainage problem for both. In such cases, the DPC has to carefully integrate the particular needs of a local area and the common needs of neighboring areas. The common interest may include area planning where a number of localities have to be planned together in respect of open space (e.g. parks and recreation sites), roads, industrial estates and so on. Commonalties among different areas may also be found in the sharing of water (say, a river or a lake), and other physical and natural resources (says, a hospital or a forest). For infrastructural development like electricity distribution, road networking, irrigation expansion etc., the DPC has to have an integrated plan for the district. Environmental conservation is another important aspect of district planning. Environmental conservation is another important aspect of district planning. Forests, water resources, soil conservation and maintenance and improvement of environmental quality general should be the responsibility of the DPL and district planning should be oriented towards this major objective.

The district plan, as framed by the DPC, will be forwarded to the state government by the chairperson of the DPC. The idea is that the draft plan will have the final approval of the state government, as resources have to be assured and the district plan has to be fitted into the overall framework of state plan.

Decentralization of the planning process has long been under active consideration in view of the vastness of the country and the need for local participation and local resource mobilization. With the introduction of

Panchayati raj, an institutional framework was created to decentralize functions and responsibilities at levels below the state. In reality, panchayati could not strike roots in many states, and institutions were not allowed to grow in foil strength for a variety of reasons. Decentralized planning, therefore, remained the district and the localities in central prescribed developmental functions. District planning was nothing but a summation of the discrete and separate activities of individual departments.

There was a growing realization that planning, to be really decentralized, has to have its basis in empowerment of local government institutions and its active people's participation. In 1992, the two landmark Constitutional Amendments ushered in the much sought-after authentic decentralized planning. The panchayati raj institutions in rural areas and the municipalities in urban areas have for the first time accorded the constitutional status of "economic development and social justice". From now on, their local self-governing institutions would be formulating their own plans for local "economic development and social justice". These local plans will be consolidated by a specially constituted District Planning Committee in each district. The DPC will prepare a draft the State Government for final approval. District Planning by the DPC, as constitutionally mandated, marks a revolutionary change in participativeness, comprehensiveness, integration and holistic vision, the district plan that will in future be formulated by the DPC in every district, is expected to be more authentic and realistic decentralized planning. It will obviously require both political will and technical skill to translate the constitutional scheme of decentralized planning into a reality. In this way Local Level Planning should be implemented.

The 73rd and 74th Constitutional amendments of the Indian Constitution have opened up new opportunities for decentralized management and people's participation in the development process. West Bengal has worked well in this direction since the years when most of the states of India even could not design properly about how to operationalise the decentralization process. While, in principle, the Panchayati Raj Institutions (PRIs) in West Bengal can be the effective bodies for local level planning and implementation, they may not be so in practice because of a number of constraints, perhaps visible in other states also.

First, all Panchayat members do not necessarily seek to achieve social goals and hence may not be sensitive to the needs of the people.

Second, diversion and misuse of resources have been reported even where the PRIs are involved in the implementation of programmes. It has also been found that the Gram Pradhans who are mostly elected from the main village (71 to 92% in different districts of the state) ignore the development of remote areas.

Third, most of the members do not have the necessary background in planning and implementation of development programmes. Often they are found to be uninformed about the local problems, specially the needs of the minorities, therefore failing to prepare priority lists relating to development issues. Over politicization very often damages the initiative for decentralized management and people's participation in the development process.

Fourth, for lack of coordination and often blurred functional link between the various tiers of the Panchayats in terms of administrative and financial control, people's participation in planning and implementation may not become effective.

Panchayats need flexibilities in operational rules, authority and financial resources if they are to participate actively in planning and implementation of development programmes. To ensure that the PRIs act in the most effective manner, the involvement of people and facilitators in planning, prioritization and implementation of programmes and in monitoring of their activities is essential. To circumvent the problem of disparity in the allocation of available financial resources between the main village and remote areas, there is, perhaps, a need for developing appropriate principles of allocation of resources at the micro level. The training and retraining of the members of PRIs may be an effective mechanism to remove most of the constraints. While some states have already created institutions for the training of Panchayat members, others too need to follow. Experienced public administrators, managers of co-operatives, NGOs and social activists/leaders should be involved in designing training courses and managing training centres. The state should evolve appropriate mechanisms to ensure harmonious working of different tiers of the PRIs. Perhaps, legislative actions would be required.

In the planning & programming stages & throughout the implementation of development projects, important information's is provided by the participatory process, which ensures the congruence between objectives of development and community values. If the local people are more involved, any change brought by the administrators for development will be acceptable to the community. Further project cost is also likely to be reduced by the

utilization of work force. Participation is a two way learning process where both the administrator and the people become co-learners. Active participation helps rebuild community cohesion and installs a sense of dignity in the community. People's participation keeps the governance legitimate. In addition, people's respect of the laws of the land is Strengthened by participate process.

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4.3 □ Exercises

1. What is financial administration referred to? Discuss its essence.
2. Budget making is the first step in Government's financial administration'. Do you agree? Justify your answer.
3. What is a Budget document? How many phases a budget system has to undergo in India? Write a note on Budget classification.
4. 'Financial administration thus forms a crucial aspect of public administration'. Explain.
5. 'Financial administration is a composite term for a number of discrete functions'. What are these?

6. Discuss the role of the legislature in budget process. Discuss the role of the executive in budget process. Discuss the principles of financial control in India.
7. Discuss the role of the Public Accounts Committee as an effective control over public expenditure in India.
8. Discuss the role of other parliamentary committees in budget process. Discuss the role of the Estimates Committee in financial administration.
9. Examine the centre state financial relations in India.
10. Analyze the role of planning in financial administration of India.
11. Discuss the role of the Planning Commission in financial administration of India. Evaluate the process of plan formulation.
12. Discuss the role of the National Development Council in financial administration of India. Why it is a significant body?
13. Evaluate the process of formulation of plan at State and District Level. Write a note on local level planning and role of DPC in this respect.
14. Evaluate the role of PRI as regards to local level planning with special reference to 73rd and 74th Constitutional amendments of the Indian Constitution.

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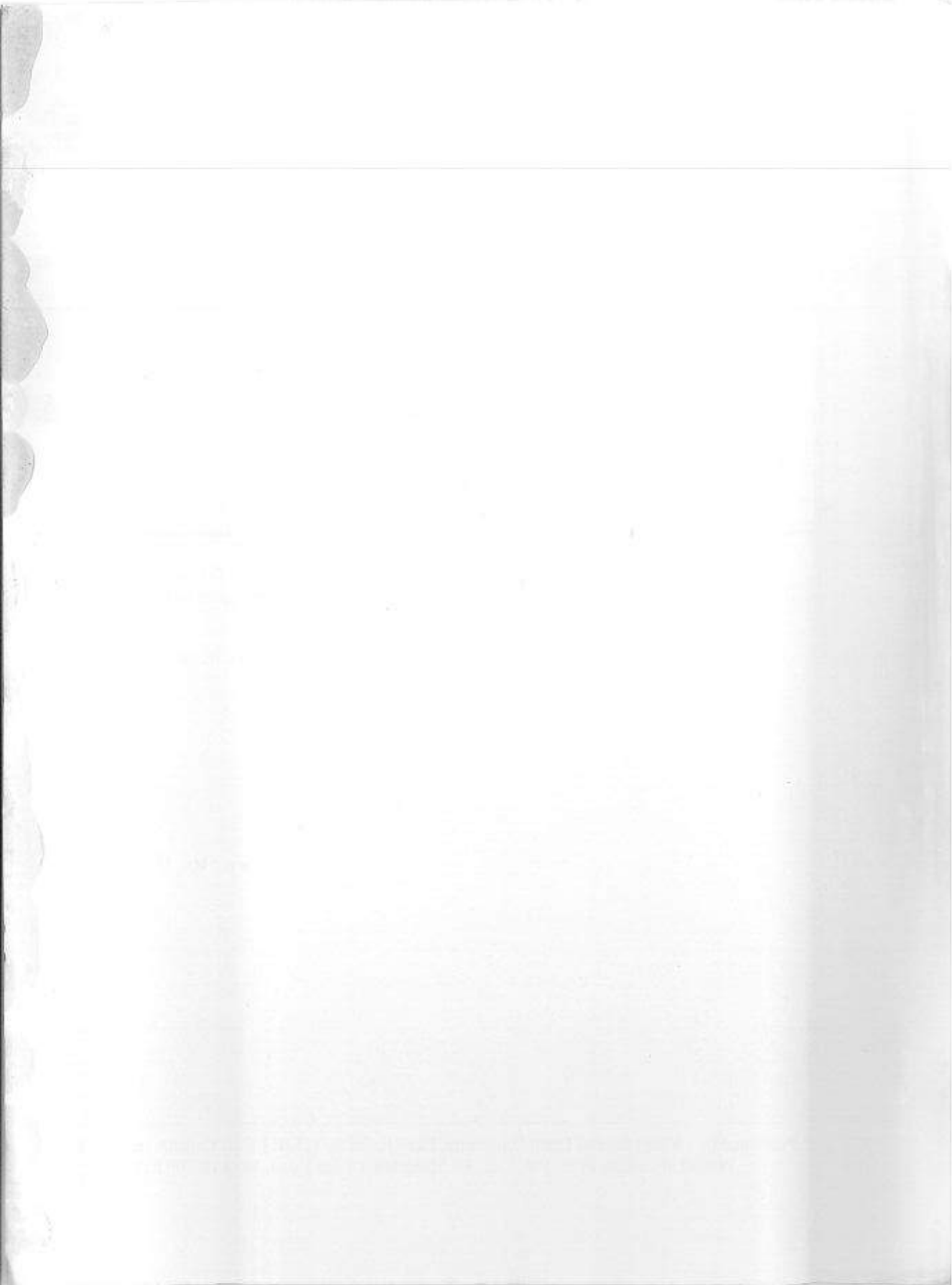
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মানুষের জ্ঞান ও ভাবকে বইয়ের মধ্যে সঞ্চিত করিবার যে একটা প্রচুর সুবিধা আছে, সে কথা কেহই অস্বীকার করিতে পারে না। কিন্তু সেই সুবিধার দ্বারা মনের স্বাভাবিক শক্তিকে একেবারে আচ্ছন্ন করিয়া ফেলিলে বুদ্ধিকে বাবু করিয়া তোলা হয়।

—রবীন্দ্রনাথ ঠাকুর

ভারতের একটা mission আছে, একটা গৌরবময় ভবিষ্যৎ আছে, সেই ভবিষ্যৎ ভারতের উত্তরাধিকারী আমরাই। নূতন ভারতের মুক্তির ইতিহাস আমরাই রচনা করছি এবং করব। এই বিশ্বাস আছে বলেই আমরা সব দুখে কষ্ট সহ্য করতে পারি, অন্ধকারময় বর্তমানকে অগ্রাহ্য করতে পারি, বাস্তবের নিষ্ঠুর সত্যগুলি আদর্শের কঠিন আঘাতে ধূলিসাৎ করতে পারি।

—সুভাষচন্দ্র বসু

Any system of education which ignores Indian conditions, requirements, history and sociology is too unscientific to commend itself to any rational support.

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